

Minnesota

Department of Finance

November 1997

Highlights

Higher Revenues, Lower Spending Improve State Budget Outlook

Stronger than expected economic activity, federal tax changes, and lower than anticipated human services expenditures result in a \$1.328 billion increase in the forecast for the 1998-99 biennium.

Property Tax Reform Account Increases to \$872 Million -- Available General Fund Balance Now At \$453 Million

State law allocates the first \$81 million of the forecast balance to fund education tax credits and deductions enacted in 1997. Sixty percent of the remainder plus dedicated interest, \$826 million, is added to the Property Tax Reform Account, bringing its balance to \$872 million. The available general fund balance at the end of the biennium is now projected to be \$453 million.

F.Y. 1997 Closes with a Gain of \$364 Million

Receipts were stronger than forecast during the last half of F.Y. 1997, exceeding forecast levels by \$272 million. Higher than anticipated final individual income tax payments were the major source of the additional revenue. Expenditures were \$92 million lower than anticipated, principally in the human services area. Much of those revenue and expenditure gains continue through 1998 and 1999.

Economic Growth, Federal Tax Changes, and Human Services Savings Add to Balance for 1998-99 Biennium

F.Y. 1998-99 revenues are now forecast to reach \$21.045 billion, \$729 million (3.6 percent) more than end-of-session estimates. The higher revenue base for F.Y. 1997 and a slight improvement in the outlook for Minnesota's economy were the major sources of additional revenue. The reduction in the federal capital gains tax rate is expected to encourage investors to realize profits more rapidly than in the past, further adding to state revenues. Expenditures are \$256 million (1.2 percent) below earlier estimates. Slower growth in human services spending accounts for nearly all of the forecast expenditure savings.

November 1997 Economic Forecast

BUDGET SUMMARY

1998-99 Budget Outlook

General fund resources for F.Y. 1998-99 are now expected to total \$21.045 billion, up \$729 million (3.6 percent) from end-of-session estimates. State expenditures during the current biennium are now forecast to be \$20.669 billion, a \$256 million (1.2 percent) decrease from previous estimates.

The ending balance for F.Y. 1997 is up \$364 million from prior estimates. The combined impact of all forecast changes adds \$1.328 billion to the estimated ending balance for the 1998-99 biennium *prior to* the allocations required under current law.

Forecast Summary: F.Y. 1998-99 (\$ in millions)

	<u>End of Session</u>	<u>Nov. Forecast</u>	<u>Change</u>
Beginning Balance	\$1,631	\$1,995	364
Revenues	20,316	21,045	729
Expenditures	<u>20,925</u>	<u>20,669</u>	<u>(256)</u>
Balance Before Reserves	1,022	2,371	1,349
Cash Flow Account	350	350	--
Budget Reserve	522	522	--
Property Tax Reform Account	46	46	--
Dedicated Reserves	72	93	21
<i>Available Balance (before current law allocations)</i>	<u>\$32</u>	<u>\$1,360</u>	<u>\$1,328</u>

Forecast Triggers Automatic Allocations, \$453 Million Remains

State law specifies the distribution of any balance projected for the 1998-99 biennium in the November forecast. First, \$81 million must be used to fund education tax credits and deductions enacted in the 1997 first special session. Second, 60 percent of the remaining balance, along with dedicated interest, is allocated to the Property Tax Reform Account. The remainder is available to the general fund.

Statutory Allocation of November Forecast Balance (in millions)

	Education Tax Credits	Property Tax Reform Reserve	Available Balance
Beginning Balance	Contingent	\$46	\$32
Allocations:			
Education Tax Credits/Deduction	\$81		
60% to Property Tax Account		\$767	
Dedicated Interest		\$59	
Remaining Balance			\$421
Balance after Distribution	\$81	\$872	\$453

A Property Tax Reform Account was created during the 1997 legislative session and funded with an initial appropriation of \$46 million. Funds within this account may be spent only to continue to reform the property tax system or to provide further property tax relief. Amounts in the account do not cancel at the end of the biennium, but remain until appropriated. Interest earned on balances in the account is dedicated to the account. As a result of the November forecast, \$767 million will be added to the account. When combined with the beginning balance and forecast interest, \$872 million is expected in the Property Tax Reform Account by the end of F.Y. 1999.

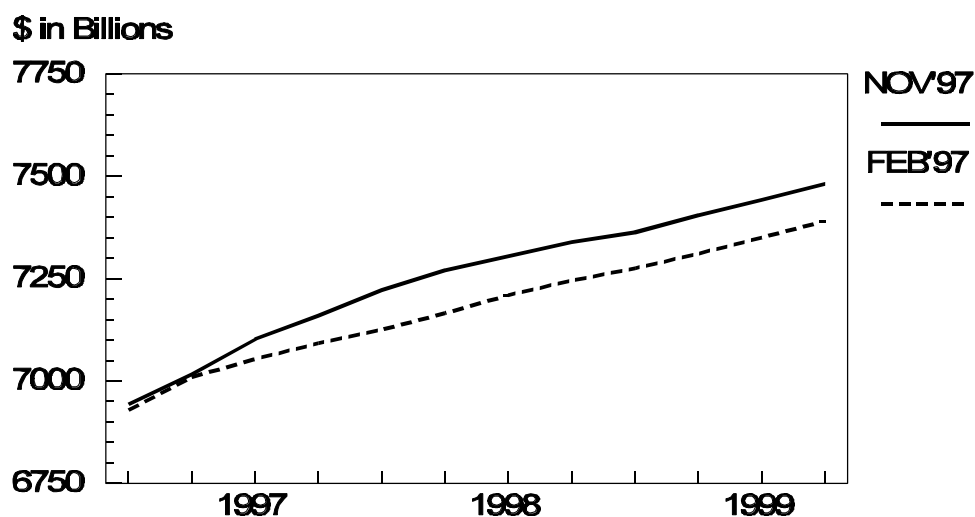
U.S. Economic Growth Continues to Exceed Projections

The U.S. economy continues to outperform earlier forecasts. Even though recent events in Asia have tempered the outlook slightly, unemployment rates are at a 24 year low and there are few signs of inflation. Never in history has the U.S. economy been this sound, this late in an expansion.

Last February, most forecasters including Data Resources Inc., (DRI) the state's national economic consultant, believed a cooling-off period was on the way, and that the real GDP growth rate would slow to below 2.0 percent in late summer. That pause would then set the stage for a continuation of the current expansion through 1999. Real GDP growth at a 3.0 percent annual rate was expected for F.Y. 1997, followed by GDP growth at 2.4 and 2.0 percent rates respectively in fiscal 1998 and 1999.

What has occurred thus far has exceeded even that optimistic scenario. There was no pause in early 1997, and GDP growth in the first quarter of 1997 was nearly double that expected. For F.Y. 1997 real GDP is now believed to have grown at a 3.3 percent rate, a full 0.3 percent more than anticipated in February. Equally important, because there have been no increases in inflation, there appears to be no need to reduce the outlook for future growth. For fiscal 1998, DRI is now forecasting 3.2 percent GDP growth, 0.8 percent more than in February. The outlook for growth in F.Y. 1999 is largely unchanged.

Economic Outlook Has Improved Since February (Real GDP - \$92)



Strong Revenue Growth in F.Y. 1997 Continues into 1998-99 Biennium

Actual revenues exceeded the forecast by \$272 million in F.Y. 1997. This 2.7 percent variance came primarily from final, individual income tax payments for tax year 1996. Those payments exceeded the forecast by more than \$200 million accounting for the largest portion of the difference between forecast and receipts. Preliminary analysis indicates that about \$60 million of that revenue was one time, and unlikely to recur in coming years. Variances for other revenues were generally small and within normal ranges.

Estimated revenues for F.Y. 1998 and F.Y. 1999 increase by \$366 million and \$364 million respectively. The individual income tax remains the source of most of the additional revenue. The higher base levels from tax year 1996 continue forward, increasing the forecast for future tax years. In addition, the strong stock market and the federal capital gains tax cut are expected to increase capital gains realizations, adding further to the forecast. The income tax changes reported below are prior to reductions for the education credits and deductions enacted in the June 1997 special session, which were contingent on the results of the November forecast.

Forecast Revenue Changes End of Session - November (\$ in millions)

	<u>F.Y. 1997</u>	<u>F.Y. 1998</u>	<u>F.Y. 1999</u>
Revenues			
Income	\$228	\$201	\$255
Sales	(28)	(5)	3
Corporate	9	62	38
Motor Vehicle	<u>24</u>	<u>43</u>	<u>20</u>
Subtotal	233	301	316
Other Revenues	32	30	39
Transfers, Misc.	7	35	9
Total Change	<u>\$272</u>	<u>\$366</u>	<u>\$364</u>

Forecast Expenditures Decline \$256 Million

Total general fund expenditures of \$20.669 billion are now forecast for F.Y. 1998-99, a decline of \$256 million from the adopted budget. Expenditures are now projected to be a total of \$348 million below end of session estimates for the three-year period F.Y. 1997-99. The lower spending estimates are primarily the result of forecast changes for health care and family support programs.

Forecast Expenditure Changes

End of Session - November
(\$ in millions)

	F.Y. 1997	F.Y. 1998	F.Y. 1999
Expenditures			
K-12 Education	5	(14)	(19)
Human Services			
Health Care	(34)	(105)	(132)
Family Support	(6)	(21)	(11)
All Other Spending	(57)	11	35
Total Forecast Spending	(92)	(129)	(127)

While actual spending for F.Y. 1997 was \$92 million less than forecast, \$37 million was brought forward into the current biennium. Even after the increase for appropriations carried forward, net spending for the F.Y. 1998-99 biennium has declined by \$256 million.

Slower caseload growth and lower per capita costs in state health care programs produced forecast savings in F.Y. 1997 as well as F.Y. 1998-99. Savings over the entire period also occurred in several family support programs due to the strong job market and lower unemployment rates.

Long Term Outlook Improves from End of Session Estimates

The increase in the F.Y. 1997 ending balance, higher revenues forecast through F.Y. 2001, and the lower estimates of the growth in human services spending in F.Y. 1998-2001 have combined to improve the state's longer term outlook.

Projected F.Y. 2000-01 revenues are now expected to total \$23.020 billion, 9.8 percent more than forecast for the current biennium. Projected spending, including discretionary inflation, would grow by 7.5 percent to \$22.220 billion.

F.Y. 2000-01 Planning Estimates (\$ in millions)

	<u>1998-99</u>	<u>2000-01</u>	
Beginning Balance	\$1,995	\$2,289	
Forecast Revenues	20,964	23,020	9.8%
Estimated Expenditures	20,669	22,220	7.5%
Cash Flow Account	350	350	
Budget Reserve	522	522	
Property Tax Reform Reserve	872	872	
Dedicated Reserves	93	61	
Ending Balance	\$453	\$1,284	

The F.Y. 2000-01 planning estimates include the effects of the statutory provisions funding the education tax credits and deductions (\$81 million in F.Y. 1999 and \$171.5 million in F.Y. 2000-01) and maintaining the Property Tax Reform Account at the F.Y. 1999 level. The projections make no assumptions about potential supplemental budget actions in the 1998 session.

ECONOMIC SUMMARY

Economists expected the U.S. economy to be a strong performer in 1997, and it has not disappointed them. October's 4.7 percent unemployment rate was the lowest in 24 years and real GDP has grown at a 4.0 percent annual rate during the past 12 months. At the same time, consumer prices are increasing more slowly than at any time since the early 1960's and there are few signs that inflation will re-emerge. Discussions of the possibility that the U.S. is entering a period of deflation, a time when prices for goods and services actually decline not simply increase at a slower rate, have filled Wall Street market letters. Never have price pressures been so subdued this late in an expansion.

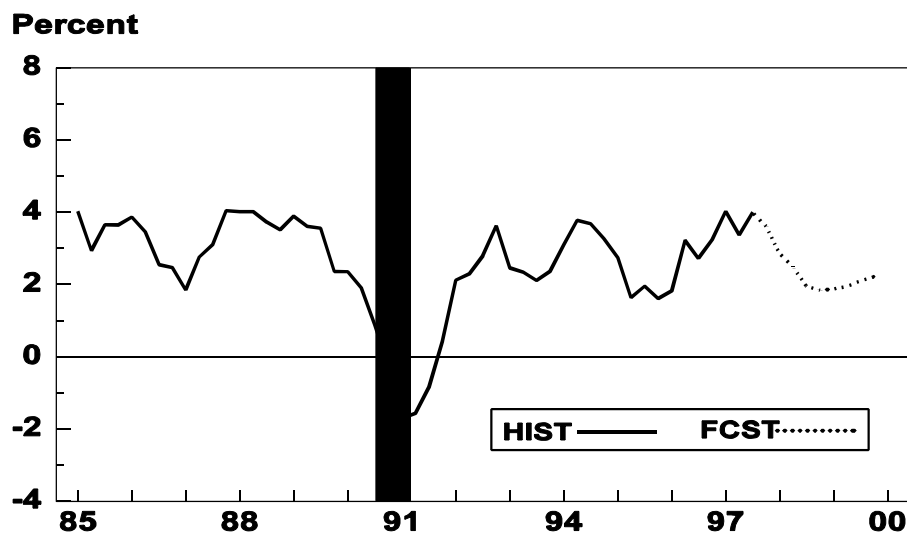
Most forecasters see nothing on the horizon that would prevent the current economic expansion from continuing through 1999. The U.S. economy now has such momentum, and inflation appears so well under control, that a downturn during the current biennium is likely only in the event of a major international incident or financial collapse. Typically, events of recent months such as the devaluation of Southeast Asian currencies, the UPS strike, and the one-day, 550 point drop in the stock market would have raised serious concerns about the outlook for future economic growth. In today's environment though, those incidents have, thus far created little concern.

The "Asian currency crisis" caused many forecasters to reduce expected GDP growth rates for 1998 by up to 0.5 percent, but that did little more than reduce GDP growth from a pace which many thought was unsustainable to one more consistent with a stable price environment. Indeed, while prior to events in Southeast Asia many had expected the Federal Reserve to raise interest rates at its November meeting, the current consensus is for no change until at least February. Several forecasters now believe that the Fed is as likely to cut interest rates in the future as to raise them.

The November 1997 Control forecast of Data Resources Inc. (DRI), Minnesota's national economic consultant reflects the consensus of most forecasters. DRI expects recent events to slow U.S. economic growth for 1998, but even when they incorporate that slowdown in their models the expected annual growth rate for 1998 is still 2.3 percent, a full 0.2 percent stronger than the 1998 outlook in last February's Control forecast. Exports will suffer from the "Southeast Asia Crisis" and consumer spending may slow as the stock market and consumer confidence come off recent record highs, but DRI notes, "So far, nothing seems serious enough to justify waving a recession flag." The Blue Chip Consensus forecast for 1998 growth is at 2.5 percent. Sixty-five percent of the economists responding to that survey projected growth rates in the narrow range of 2.3 to 2.7 percent. DRI now expects real GDP to grow at an annual rate of 2.0 percent rate in 1999.

Members of Minnesota's Council of Economic Advisors and Department of Finance economists agreed that DRI's November Control forecast was consistent with that of most forecasters. The Department of Finance noted that even though DRI was at the low end of the Blue Chip Consensus, there were no material differences between the Control and most other forecasts. Most Council members' individual forecasts were at or above the level of the November Control, and several members were significantly more optimistic in the short term than DRI. Others noted that the nationally tight labor market will act to slow growth and that some increased inflationary pressure due to higher wages is likely.

Real GDP Growth Will Continue, But at a More Subdued Pace



Finance Department economists and several Council members questioned whether the Asian currency problems would have as large an impact on exports and imports as DRI has incorporated into their November Control forecast. Finance Department economists also noted that Minnesota's tight labor market could cause this state, and other Midwestern states to under perform the national averages since economic growth may proceed more rapidly in regions where additional workers are more readily available.

DRI assigned a probability of 55 percent to their November Control Scenario. Boom-bust, a scenario in which slightly stronger near term growth causes inflation to accelerate, leading in turn to Fed tightening and a recession in 2000, is assigned a probability of 35 percent. A scenario in which the stock market drops more than 15 percent over the next 5 months, leading to a loss in consumer confidence, diminished retail sales, and a minor slowdown in late 1998 is assigned a probability of 10 percent. Council members agreed that the probability DRI assigned Control was appropriate and that the U.S. economy was about as likely to exceed the control forecast as to fall

below it during the remainder of the 1998-99 biennium. Everyone agreed, however, that the amount by which growth could exceed the forecast was substantially less than the amount the forecast could fall short should the economy encounter a major shock. Council members also noted that differences between the boom-bust scenario and the Control scenario were small until mid 1998, making it difficult to determine whether the economy remained on the desired non-inflationary track, or was moving closer to a situation where significant interest rate hikes would be necessary to slow inflation.

Finance Department economists warned that several technical and behavioral factors associated with the individual income tax could cause a significant change in the revenue forecast, even without a change in the underlying economic outlook. Changes in federal income tax treatment of capital gains and IRA contributions are likely to change taxpayer behavior. That, in turn, could change rates of growth for portions of the Minnesota income tax base. The Finance Department noted that its econometric analyses of the results of past changes in the capital gains tax rate showed no reason to expect large one time revenue increases from the unlocking of large holdings of stock or real property. Extraordinary growth in fourth quarter estimated individual income tax payments, due January 15, 1998, would force a re-evaluation of the outlook for capital gains in 1997 and 1998, however.

A recent *Wall Street Journal* article described a second technical problem from the federal perspective. Federal individual income tax receipts during fiscal 1997 exceeded the U.S. Treasury's February forecast by nearly 10 percent, or about \$64 billion. The article notes that while about \$18 billion of that additional revenue can be explained by a stronger economy, the source of the remaining \$46 billion remains in question until data from the 1996 tax forms can be analyzed. This leaves open the question of whether that revenue increase can be considered permanent and likely to continue, or a only a one-time windfall which does not add to the long term base.

Final payments exceeded forecast levels in Minnesota, but on a much smaller scale. Final liability for tax year 1996 now appears to have been about 5 percent (\$206 million) more than projected in February. Finance Department economists believe that the additional, one-time revenue associated with mergers and acquisitions and transitory increases in taxable farm income substantially exceeded the amounts included in February's forecast. That change explains only part of the variance in tax year final payments however. The remainder now appear to be due to stronger growth in capital gains and in wages. In the November forecast 1996 growth rates for each source of taxable income were adjusted to levels consistent with current estimates of final tax year 1996 liability. In February 1998, actual tax year 1996 liability will be available as will results from a sample of tax filers. When that data is used as the base for the 1997, 1998, and 1999 income tax forecasts, there could be significant changes from November's revenue projections, even in the absence of any change in the economy.

ECONOMIC OUTLOOK

By most measures, the economy seems more robust than at any time since the 1960's. Forecasters are surprised by slowing inflation when GDP growth is well above its sustainable trend. Reflecting the strong momentum, DRI expects the current expansion to set a new postwar record for longevity despite a threat of higher inflation from tightening labor markets and the potential for further stock market volatility which could dampen consumer spending.

No one knows for sure there will be a new record. It is easy to forget that almost any consumer led expansion is more tenuous than the record setter of 1961-1969 which was driven by tax cuts and defense spending. Economists generally agree the good news shows no sign of ending soon because there appear to be no significant destabilizing forces developing. October's stock market downturn reversed so quickly it has not noticeably discouraged consumers. Wage gains have accelerated a bit, but do not seem to be turning into higher inflation which could be followed by a chilling spike in interest rates. Fallout from financial market turmoil in Asia will slow the U.S. economy in 1998, but DRI does not currently expect this to turn into a recession.

Over the past several months, two perspectives on the outlook have emerged which are not shared by mainstream economists. Some observers say a "new economy" has evolved in which undetected productivity gains are holding down increases in labor costs while global competition keeps firms from raising prices. In this view, the economy's new structure allows faster real GDP growth than the consensus estimate of 2.0 to 2.5 percent, possibly as much as 3.5 percent annually without accelerating inflation. In contrast, other analysts think excess worldwide manufacturing capacity in autos, chemicals, electronics, steel, ships, and apparel coupled with weakening economies and financial market turmoil in Asia may cause a deflation or general decline in prices. This would result in falling profits and sharp cutbacks in investment spending, leading to a worldwide recession which inevitably spreads to the U.S.

According to DRI and most other mainstream forecasters, renewed inflation followed by sharply higher interest rates at the hands of the Fed, the markets, or both, remains the principal risk to continued expansion. Another possibility is consumer retrenchment following a major stock market correction precipitated by Asian currency turmoil or a sudden run up in energy prices. But, the forecasters say, one way or another this expansion must eventually end because currently modest inflation is not a "new economy," just temporary good luck consisting primarily of favorable labor market conditions.

The November Control incorporates some elements of the deflation view without coming to the conclusion that a U.S. recession will result. While deflation overseas may slow U.S. exports enough to shave 1998 real GDP growth by about one-half percentage point, this does not seem to pose a serious risk and may indeed be of some benefit if the

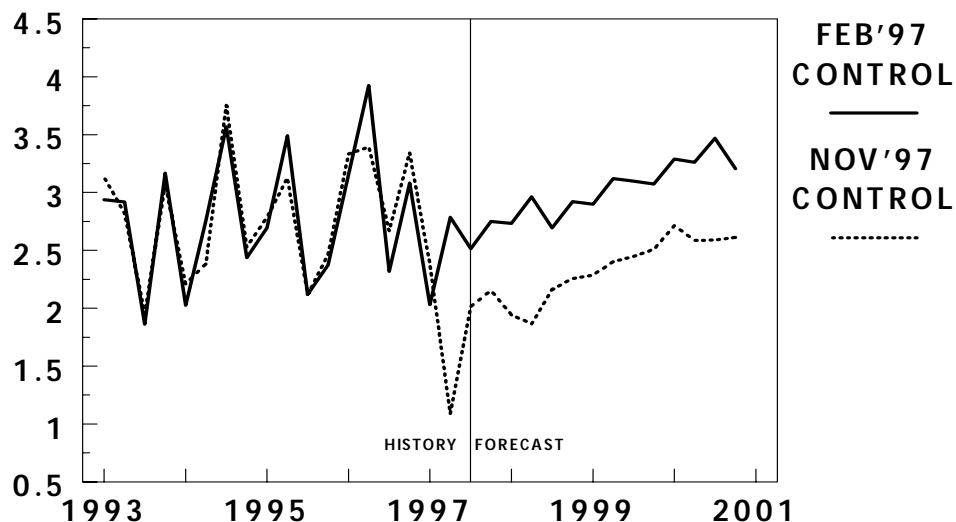
economy cools enough to eliminate the need for higher interest rates next year. In the opinion of Finance Department economists, this outlook could change if International Monetary Fund bailouts and domestic banking reforms fail to keep Asian currency maladies from spreading to Japan and China.

Real GDP Exceeds Forecasts, Good Luck Slows Inflation

Real GDP increased 4.0 percent over the last four quarters, significantly above the 2.0-2.5 percent trend considered to be sustainable, and much higher than the February Control's 2.8 percent projection. During the same period, consumer prices rose 2.2 percent, less than the 2.6 percent DRI expected. The price level's surprising performance was accomplished as unemployment fell to 4.7 percent in October, below most estimates of the non-accelerating inflation rate (NAIRU).

Economists think an almost incredible run of good luck is offsetting inflationary pressure. Most important are favorable labor market conditions not reflected in relatively low unemployment. Helping out are still small increases in employer's health care costs, a strong dollar which has reduced imported goods prices, weakness in overseas economies which has kept commodity prices in check, lower energy costs, and strong investment spending which has expanded industrial capacity just ahead of demand. There may also be at long last a sharp improvement in measured productivity which would justify cautious optimism. Probably the most one can reasonably hope is that productivity is shifting upward modestly from its 1.1 percent annual trend of the past several years.

**Consumer Price Index
(Annualized Percent Change)**



The biggest economic news of the year is that consumer inflation has come in significantly lower than expected in February. Lower inflation is expected to continue into the foreseeable future.

Subdued Inflation A Pleasant Surprise, But Can It Last?

Federal Reserve Chairman Greenspan has said that inflation's recent surprising performance is marvelous, but unlikely to last indefinitely. In 1998, wages will rise more rapidly in tightening labor markets, a profit squeeze at HMO's is likely to lead to higher employer health care costs, and the dollar's exchange value will begin to erode, making imported goods more expensive. Wages will be the center of attention because they constitute two-thirds of unit output costs and because, as Dr. Greenspan put it to Congress, the laws of supply and demand for labor have not been repealed.

This remark apparently refers to the debate between economists and non-economists as to why prices show so little sign of rising as the NAIRU theory predicts. Some non-economists assert that a "new economy" or "new paradigm" has emerged during the last few years which will tolerate stronger growth without rising inflation. According to the new economy's proponents, sustained real GDP growth above the 2.0-2.5 percent range is possible. They contend that if the Federal Reserve let GDP grow faster, firms could increase sales without additional hiring and without paying inflationary wage increases because the new information technologies would allow workers already in place to produce additional goods and services. Firms would also be unable to raise prices significantly because gradual removal of trade barriers is leading to a struggle for market share on a global scale much like the one the auto industry is already engaged in.

Is There A New Economy?

Most economists are highly skeptical there is new economy. For example, former Federal Reserve vice-chairman Alan Blinder writing in *The American Prospect*, MIT's Paul Krugman writing in the *Harvard Business Review*, Alan Greenspan in Congressional testimony, and DRI in their monthly *Review Of The U.S. Economy* all discount the possibility that real GDP growth above 2.5 percent annually is sustainable without renewed inflation. Generally, they all say that the new economy's advocates do not understand productivity data and concepts.

These mainstream economists point out that just because productivity may be underestimated does not mean the economy has unused labor resources. Productivity and real GDP are measured with the same data. If one is underestimated, then the other is too, so both actual and potential output are higher than published statistics show. If productivity is really growing faster as suggested, then workers somewhere are producing additional goods and services not captured in the data. Consequently, error in measuring productivity does not necessarily mean there is slack in the economy.

Unused resources do exist if some people are in jobs underutilizing their skills or which do not allow them to work all the hours they want. So-called total factor productivity, additions to total output attributable to skills and technology, has not increased for many years. No one really knows why this has occurred. It could be that structural

problems in the economy are keeping some workers in jobs which do not fully utilize their potential. Such problems might be caused by distortions from tax, environmental, or other policies. Unfortunately, pro-growth, pro-efficiency policy changes have been analyzed and debated for years without consensus as to the benefits. It is also true that some part-time workers would take full time jobs if they could find them and produce more goods and services than they do now. However, no one claims simple underemployment can be a significant reason for below potential GDP growth.

Measurement error and inefficiency may not be the critical issues. Goldman-Sachs economists contend the new economy's assumption that rising productivity can hold the lid on prices indefinitely is fallacious. If productivity is shifting to a new, higher trend, this can only make a temporary difference. Once wage inflation begins it will accelerate because of rising expectations as long as unemployment remains below the NAIRU. Wage increases eventually must outstrip productivity gains which cannot accelerate indefinitely. So, movement to a higher productivity trend, which recent data suggests may be underway, gives the economy extra time before wage increases become inflationary, but it does not usher in a new era.

Labor Markets Are Not As Tight As Once Thought

Favorable labor market conditions are generally considered to be the most significant factor in the mild inflation climate. Recent reports by DRI and *Business Week* show that more workers are available to employers than historically has been the case at current unemployment rates. Both initial claims for unemployment insurance and the ratio of job losers to voluntary job leavers remain high for an expansion almost seven years old, at least in part because of layoffs from continued downsizing. In addition, normal labor force growth is being significantly augmented by returning retirees ages 55 to 64. During the past 2 years, *Business Week* calculates this group representing 9 percent of the labor force has accounted for 22 percent of total job gains.

Though relied on by policymakers, the unemployment rate and the NAIRU derived from it are widely known to be crude measures of labor market tightness. So, the recent discovery that there are more labor resources in the economy than unemployment alone indicates comes as no great surprise. As a result, estimates of the NAIRU are declining. A few years ago, most economists thought it was about 5.8 to 6.0 percent. Now it seems that 5.2 to 5.6 percent is a better choice for at least the near future, though some analysts believe 5.8 percent will be a better estimate in the long run once the pool of available labor resources is drawn down a bit more by above trend growth.

Good News Does Not Mean No Risk

DRI believes the outlook is so favorable this expansion will replace the one of the Vietnam era as the longest in U.S. postwar history. To do that, the good news will have

to continue at least until February, 2000, or 107 months after the last recession ended in March, 1991.

As DRI sees it, there are currently two foreseeable downside risks. One is that the Federal Reserve made an error in not raising interest rates last summer once 1997's above trend growth became known. Should this be the case, it may now be too late to head off rising inflation with incremental moves, raising the risk that the Fed will overreact to rising demand or signs of renewed inflation. The other risk is that a major stock market correction precipitated by financial turmoil in Asia, or some other unforeseen shock could undermine heavily indebted consumers confidence and spending, depriving the economy of its principal driving force.

Consumption

During the summer, confidence soared and inflation adjusted household spending rebounded. Outlays rose at a rapid 5.8 percent annual rate in the third quarter, up from only 0.9 percent in the second, and significantly faster than the 3.3 percent increase in real GDP. Confidence as measured by the University of Michigan survey is at a record high, reflecting the current combination of stock market generated wealth, the lowest unemployment rates since 1973 and, except when oil prices collapsed in 1986, the lowest inflation since the 1960's. Although spending has apparently slowed from its third quarter pace, most indications are that retailers will have a good Christmas season. If somehow they do not, it could be the first sign that the consumer spending boom is winding down.

To economists, excessive consumer optimism looks like a bubble just waiting to be pricked. The overvalued stock market became the proverbial pin about a year ago. Now, to compound the concern, memories of previous downturns appear to be fading. DRI reports that a recent Michigan survey shows that three of four consumers expect the unemployment rate to remain at or below its recent 25 year low. Such ebullience ordinarily occurs early in an expansion rather than several years into one. If this means caution has been tossed to the winds, then an appropriately timed bit of even modestly bad news could surprise many individuals, causing a sharp slump in spending.

As confidence rose, spending gains outpaced income, driving the saving rate down. Revised National Income And Product Accounts data released in July imply consumers are spending annually the equivalent of about 3 percent of changes in their stock market wealth, some of it by diverting savings from current income into installment payments. Preliminary data did not show this, causing some observers to erroneously speculate that baby boomers were finally boosting their savings for retirement. Unfortunately, that is not the case.

Credit outstanding as a share of disposable income is at record heights though Federal Reserve Board data shows debt accumulation is slowing. DRI suggests this may be because banks are becoming less willing to make consumer loans. Provided debt relative to income rises no higher, DRI expects increases in personal bankruptcies will

ease sometime in 1998. That would help diminish concern outstanding debt could significantly worsen a consumer led recession.

Investment

Favorable interest rates and the economy's strength are causing a rebound in investment spending by households and business firms. Households eager to lock in low mortgage rates are keeping homebuilders busy. Firms taking advantage of both good internal cash flow and equity financing made attractive by high stock prices relative to earnings are building new plants and installing new equipment.

The Economist reports that in 1996 some 40 percent of total equipment investment was for information technology. But somewhat surprisingly, low-tech investment has made a comeback. *Business Week* indicates spending for traditional machinery is up sharply with the result that manufacturing capacity is increasing at about 4 percent annually, twice as fast as it did in the early 1990's. The new plant and equipment is much needed because capacity utilization recently rose to 84.3 percent, the highest since March, 1995, and just below the 85 percent level generally considered to lead to increased inflation.

Should there be a deflation in prices for internationally traded goods, many U.S. manufacturers could experience a profit squeeze that would force them to cut back plans for future investment spending. It is unclear to Finance Department economists whether this alone could endanger the current expansion as long as consumer outlays are unaffected. The November Control forecast and its alternative scenarios do not explore this possibility.

Government

DRF's February outlook generally anticipated the technical parts of the early August budget agreement negotiated by Congress and President Clinton. Consequently, only fine tuning was needed to adjust the forecast for Treasury's most recent estimates of the impacts of the new tax and budget laws.

The agreement's consequences for the budget outlook, however, were a pleasant surprise. Unexpected windfalls, some in the form of tax revenues from capital gains and some just mystery money according to the *Wall Street Journal*, together with cost savings from declining inflation resulted in a sharp reduction in the federal deficit in fiscal year 1997. This lowered the Congressional Budget Office baseline projection for future deficits, making the budget negotiations much easier. The outlook is now so much improved that the November Control projects a small unified budget surplus in 2002 even if some of the spending cuts in the agreement are not enacted. But both the forecast and the budget agreement depend on the economy staying out of recession and substantial growth in capital gains realizations.

International

While posing relatively little foreseeable risk, the growing trade deficit is one of the few negative influences on the economy at this time. Leveraged by the dollar's relatively high foreign exchange value, rising domestic purchasing power in the U.S. is pulling in imports while soft overseas demand in Japan, Southeast Asia, and Europe holds exports down. DRI does not expect this situation to change soon despite rapid improvement in the economies of Canada and Mexico, our largest and second largest (Japan is third) trading partners. Consequently, the trade deficit is forecast to increase through 1998 before stabilizing for the next few years. The rising deficit will force a weakening in the dollar's exchange value which may get underway soon.

Some of the dollar's current strength comes from demand by international investors purchasing U.S. stocks and bonds as they move their funds out of weak Southeast Asian currencies, out of Japan's floundering economy, and out of Europe because of uncertainty over the impacts of implementing the European Monetary Union. But, these investors now face the prospect of exchange losses due to a declining dollar which may cause some to pull out of the U.S. markets. At present, analysts seem unconcerned about the risks this possibility may pose for stock prices and interest rates.

Monetary

Higher U.S. interest rates are not likely soon. After October's wild swings in the stock market most observers are convinced that the Federal Reserve is reluctant to chance a rate hike which could precipitate another stock market correction. Hopefully, by waiting until spring, the Fed will not have to make a choice between a stable market and subduing inflation. The November Control assumes another tightening in March, 1998, but many believe this may not be needed if the economy cools.

Despite the third quarter's above trend real GDP growth and unemployment below most estimates of the NAIRU, the Fed has not raised rates since last March. While Dr. Greenspan has speculated about the "new paradigm" in public comments, virtually no one thinks the Fed has held off because he believes the U.S. economy has fundamentally changed. His repeated expressions of concern about inflation and the remark that the laws of supply and demand for labor have not been repealed have roiled the financial markets, indicating they are convinced the Fed's ultimate priority continues to be inflation.

While the Fed's priorities are unchanged, it might have a new strategy. It is possible that Dr. Greenspan is not responding to 1997's strong growth because there is now less risk in waiting to tighten until there are more signs of accelerating inflation. A few years ago, he told Congress that he needed to anticipate price increases and pre-empt them, raising the possibility of raising rates unnecessarily. The risk of a policy mistake seemed acceptable at the time because it was reasonable to assume individuals would automatically raise their already high inflationary expectations at the first sign of accelerating price increases. In these circumstances, inflation was likely to pick up very rapidly, leaving the Fed struggling to catch up by using draconian interest rate

moves to significantly dampen both demand and expectations at the risk of causing a recession.

Waiting may now be a viable option because there is less need to pre-empt or to react strongly if prices spike up. Goldman-Sachs economists report that the University of Michigan consumer confidence survey shows inflationary expectations are easing. This explains why the difference between yields of ordinary 10-year Treasury notes and 10-year Treasury inflation protected securities (TIPS) has declined sharply this year. As long as expectations are trending downward, it is much less likely individuals will quickly demand wage increases to protect their purchasing power should a few bad inflation numbers appear.

A *Business Week* article reported the Bundesbank raised short term interest rates in early October. Additional increases will probably be needed to synchronize German rates with higher rates prevailing elsewhere in Europe before monetary union goes into effect. This will slow already weak growth on the Continent and eventually put upward pressure on rates in U.S. financial markets. While the transition to monetary union seems to pose little risk to the U.S. economy, analysts may focus more on this issue in the future.

Inflation

During 1997, prices have increased much less than expected. According to economists at American Express Financial Advisors and at Goldman-Sachs, some of this can be attributed to changes in the way consumer inflation is measured which are not being applied retroactively. The rest is real, surprising most forecasters. DRI now estimates consumer prices will rise 2.4 percent in 1997 and 2.0 percent in 1998, down from their February forecast for 2.7 percent in 1997 and another 2.7 percent in 1998.

Retail inflation's recent performance scarcely compares with what has happened to producer prices. In July, the Producer Price Index fell for an unprecedented seventh month in a row. The decline has since leveled off, but soft producer prices and the lowest consumer inflation since the 1960's have led a few economists including those at Merrill Lynch and at Morgan Stanley, to suggest the U.S. is likely to soon experience deflation or a general decline in prices. This view is supported by prospects for intense price competition from Asian manufacturers as their governments urge more exports to support weakening economies. Most economists, including those at DRI, acknowledge the Asian problem and the existence of global excess production capacity, but remain skeptical these will have significant U.S. impacts. In their view, manufactured goods have too small a share of the services dominated U.S. economy to overcome the inflationary effects of higher wages as labor markets gradually tighten.

MINNESOTA OUTLOOK

Minnesota payroll employment is now estimated to increase 2.2 percent in 1997, up from 1.7 percent forecast in February. Total wages are forecast to rise 5.5 percent, up slightly from 5.4 percent. For the U.S., DRI forecasts 1997 employment will rise 2.2 percent, slightly more than February's 2.1 percent, while total wages are expected to increase 6.5 percent, up from 5.7 percent.

For 1998, Minnesota jobs are forecast to rise 1.8 percent, compared to 1.4 percent forecast in February. Total wages are projected to increase 5.2 percent, up from 4.8 percent estimated earlier. In comparison, 1998 U.S. jobs are expected to rise 1.9 percent, up from 1.6 percent, while total wages are forecast to rise 5.2 percent, up from 4.8 percent.

This potentially optimistic outlook depends on employers being able to find people in a tight labor market to fill projected job openings. Unemployment continues to shrink. The Minnesota seasonally adjusted unemployment rate averaged only 3.2 percent through October, compared to 4.0 percent for the 12 months of 1996.

While recent research by the Minnesota Department of Economic Security indicates employers are having serious difficulty finding many kinds of workers, there appears to be no statistical evidence that job growth has been constrained. Yet, this seems inevitable. Employment continues to expand at around 2.0 percent annually while Economic Security estimates potential long term labor force growth to be only 1.1 percent. The difference is being made up in the short term by drawing down the pool of unemployed and by higher labor force participation and migration. As in the national economy, increased labor force participation by recent retirees appears to be augmenting the labor force. Finance Department economists believe that migration into the State is also a significant contributor. But, the pool of retirees is finite and there is no way to guarantee migration will be as helpful in the future.

The expansion of the past few years has been accompanied by strong growth in the Midwest, leaving labor resources close to full utilization in most neighboring states. Historically, the State Demographer's Office indicates these states have been the principal source of people moving here. Their strong economies may now make migrating to Minnesota look relatively less attractive.

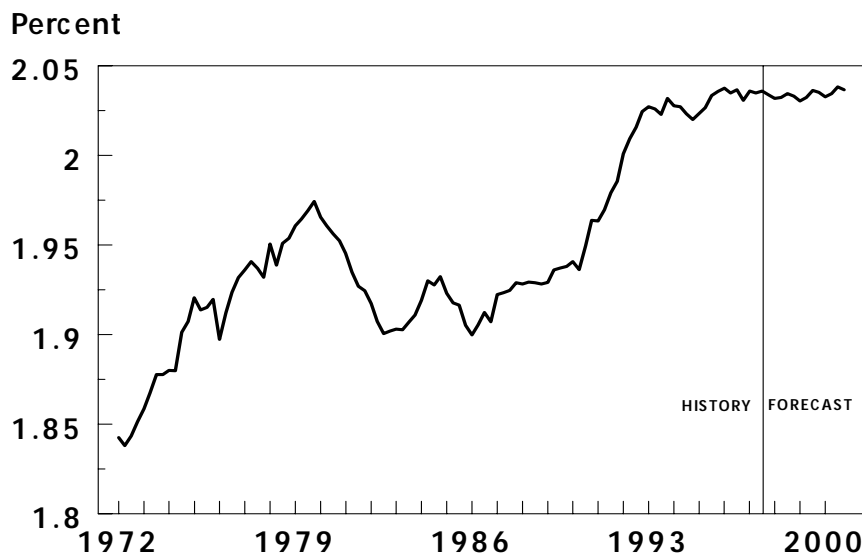
Minnesota Could Underperform The Nation

For some time, the Minnesota economy has outperformed its national counterpart. Consequently, the State's shares of nationwide jobs and total wages are at or close to record highs. At this point, further increases in share seem unlikely. In the November forecast, Minnesota jobs and total wages grow at rates close to their national counterparts, leaving the shares relatively constant. Finance Department economists

believe there is downside risk to this outlook because there is no way of knowing how long Minnesota labor resources can support it.

A special DRI analysis suggests tight labor markets are constraining further midwestern expansion. So, if the U.S. economy expands as in the November Control, a disproportionate part of additional activity may occur in New York, Texas, and California. These states have ample labor resources as indicated by unemployment rates which significantly exceed the national average and large, diversified economies. If enough local employers find it more practical to expand elsewhere, then Minnesota job numbers may drop below forecast and the State's share of total employment and wages will fall.

Minnesota Share of Total U.S. Jobs



Minnesota's economy is forecast to expand rapidly enough to maintain a relatively constant share of total U.S. jobs. This outlook depends on employers being able to find people in a tight labor market to fill projected job openings.

Potential Consequences Of Underperformance

Should Minnesota's shares of jobs and total wages decline, sales tax revenues, motor vehicle excise revenues, and possibly others could come in below forecast. Since there is no state specific data on household spending, on business investment outlays, or on expenditures for motor vehicles, tax revenues from these expenditures are forecast using proxies constructed by multiplying a Finance Department forecast of Minnesota's share of jobs or total wages by nationwide spending projections generated by DRI. If the forecast share is too high, then the revenue estimate based on it is also likely to be too high even if the DRI national outlook is accurate.

Some Manufacturing Will Weaken

While the general deflation suggested by some observers seems unlikely at this time, soft producer prices are already reality. If this persists as forecast, there will be an impact on certain Minnesota manufacturing industries. The Finance Department model of the State economy is not detailed enough to pick out specific firms or products, but it suggests there will be downward pressure on profits and employment growth primarily in the electric machinery, industrial machinery, fabricated metal products, and apparel industries.

The November forecast assumes these industries will begin to feel the pinch sometime during 1998, though the timing will depend on unknown inventories and order backlogs. Some weakness in computers may be offset by IBM's recently announced move of Texas based RS6000 operations to Rochester, though there has been no news of additional jobs there as a result. Ford has denied a report that it will close its plant in St. Paul, so at present there seems to be no reason to expect weakness in the transportation equipment sector.

Wage Data Update

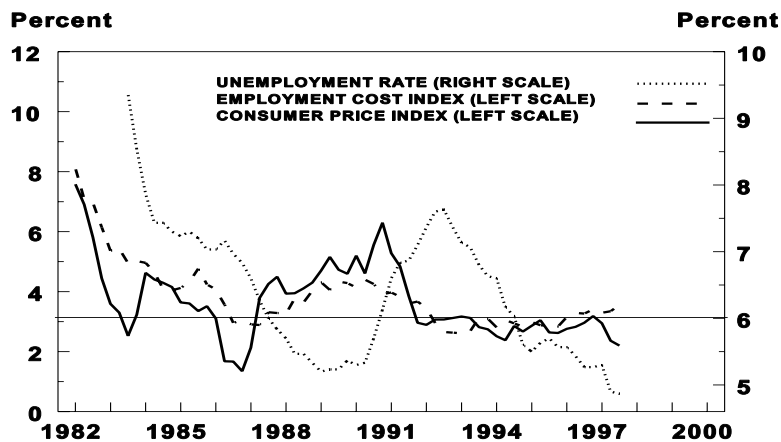
Estimates of wages paid in Minnesota during recent years are a key variable used in the model of the State economy and in the income tax model to age the sample of returns. In the November forecast, the income tax model uses U.S. Department of Commerce information on wages paid since 1995, the last year sampled.

Beginning last year, Minnesota wage information from the U.S. Department of Commerce has been less useful than that provided earlier because the newer data is more difficult to reconcile with income tax collections. Commerce indicates it is using a new seasonal adjustment procedure and is introducing methodology to account for unreported employer contributions to tax-deferred retirement plans. Since these contributions are not taxed or subject to withholding, one would expect that data including them would be less related to collections. But there appeared to be quality problems that went beyond changes announced by Commerce.

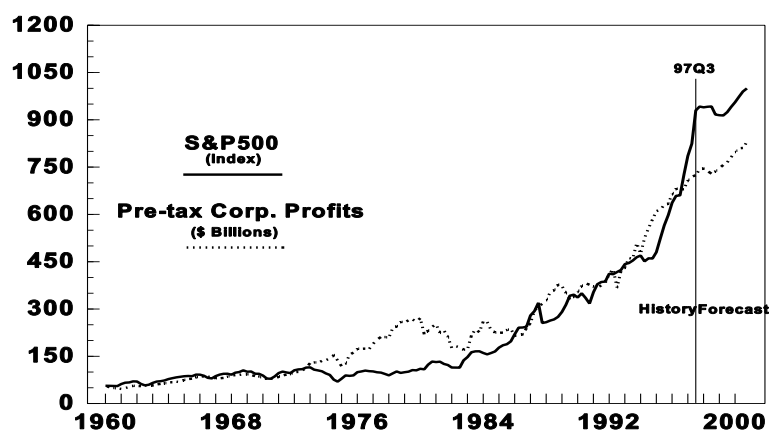
Fortunately, the Minnesota data released in early November were much improved. This information came too late to be used in estimating Finance Department models of the state economy and tax structure. However, adjustments outside the models were made take into account the substance of the revisions. As in the past, wage data from the Department of Economic Security was used as a guide for adjustments to the Commerce data.

Selected National Economic Indicators

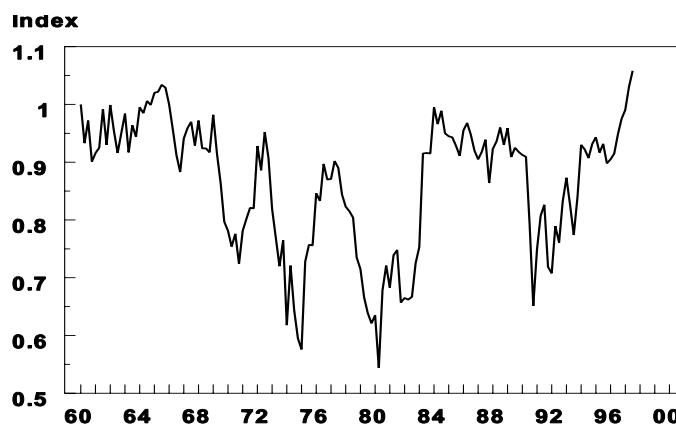
INFLATION AND UNEMPLOYMENT



CORPORATE PROFITS AND THE STOCK MARKET

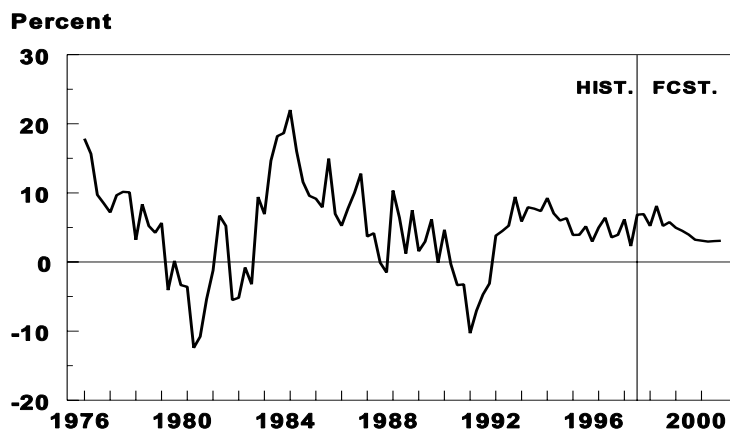


INDEX OF CONSUMER SENTIMENT

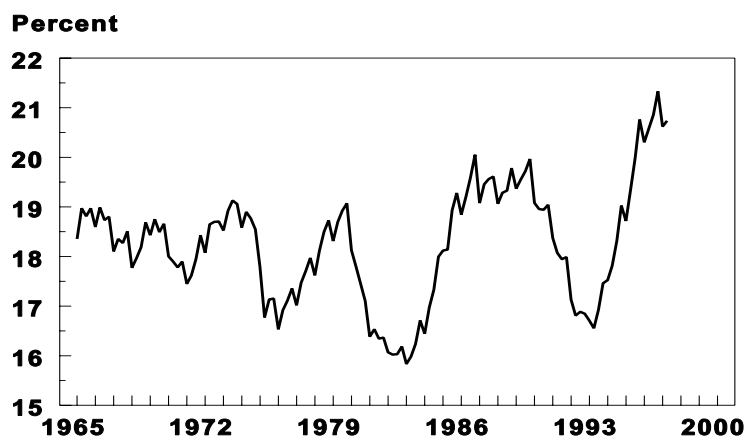


Selected National Economic Indicators

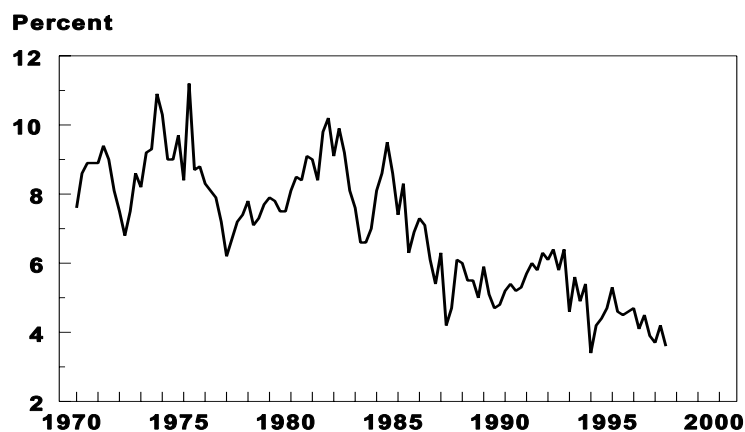
GROWTH IN REAL CONSUMER DURABLES SPENDING



INSTALLMENT CREDIT OUTSTANDING AS A PERCENT OF DISPOSABLE INCOME

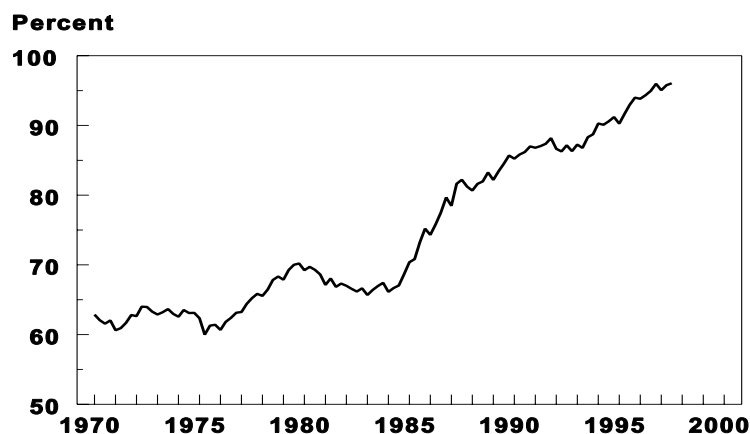


SAVING AS A FRACTION OF DISPOSABLE INCOME

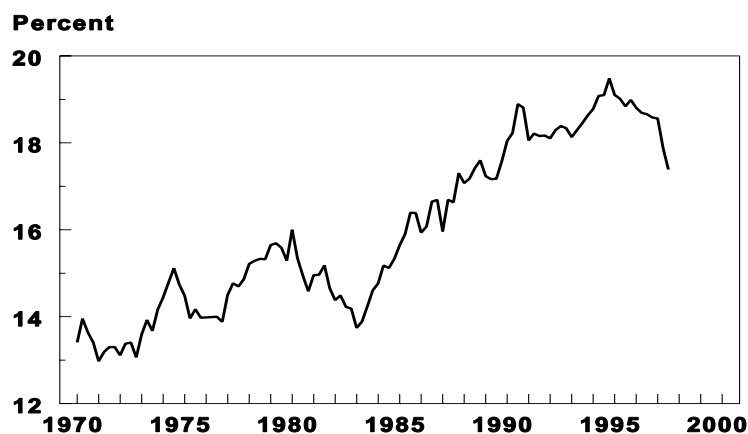


Selected National Economic Indicators

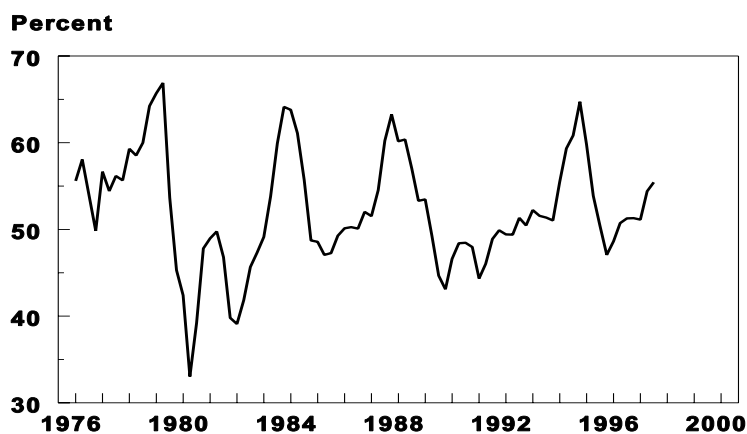
HOUSEHOLD FINANCIAL LIABILITIES
AS A SHARE OF DISPOSABLE INCOME



HOUSEHOLD FINANCIAL LIABILITIES
AS A SHARE OF NET WORTH

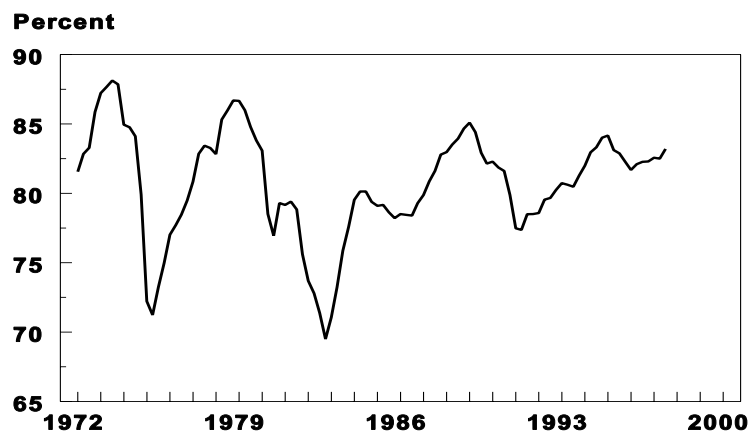


PROPORTION OF
COMPANIES RECEIVING SLOWER DELIVERIES

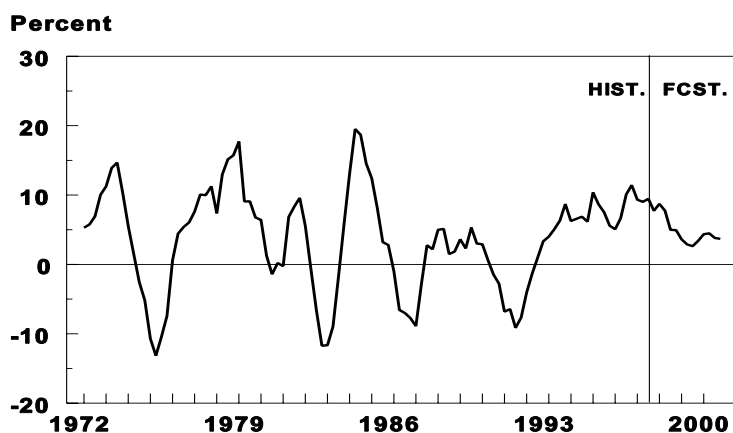


Selected National Economic Indicators

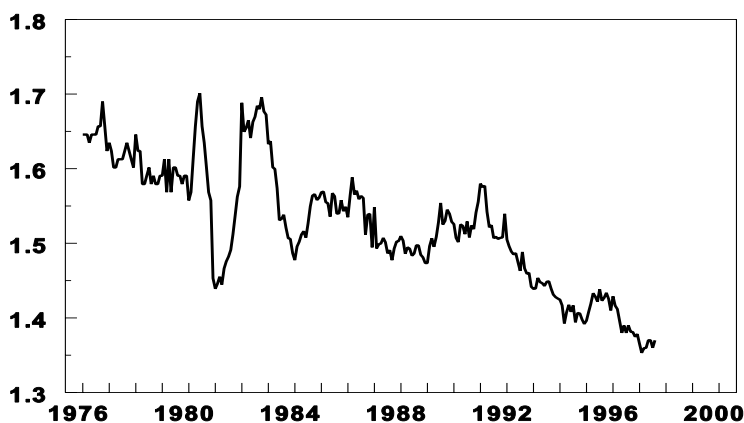
MANUFACTURING CAPACITY UTILIZATION



REAL BUSINESS INVESTMENT IN PLANT AND EQUIPMENT

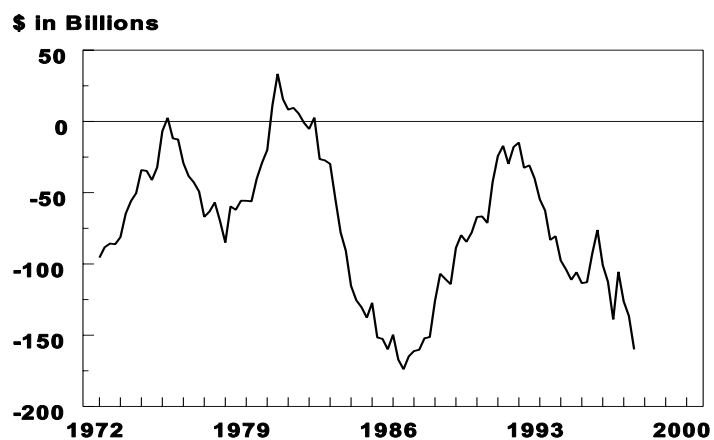


MANUFACTURING AND TRADE INVENTORY TO SALES RATIO

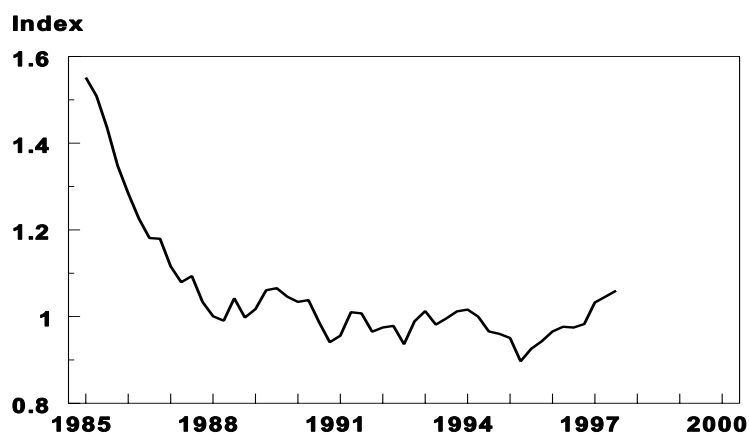


Selected National Economic Indicators

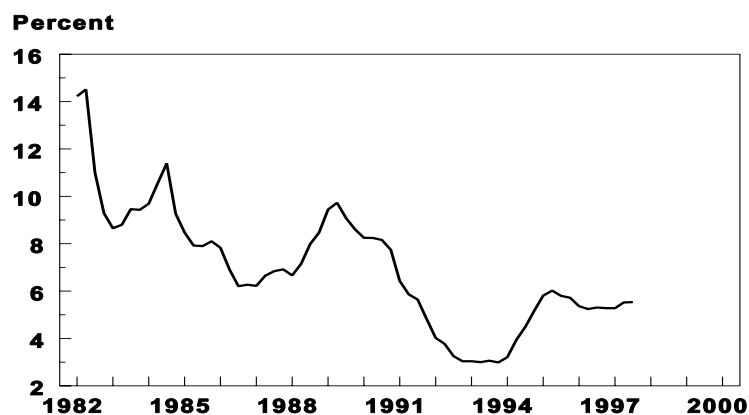
U.S. TRADE BALANCE (\$1992)



TRADE-WEIGHTED VALUE OF THE DOLLAR



FEDERAL FUNDS RATE



ISSUE HIGHLIGHT

Capital Gains

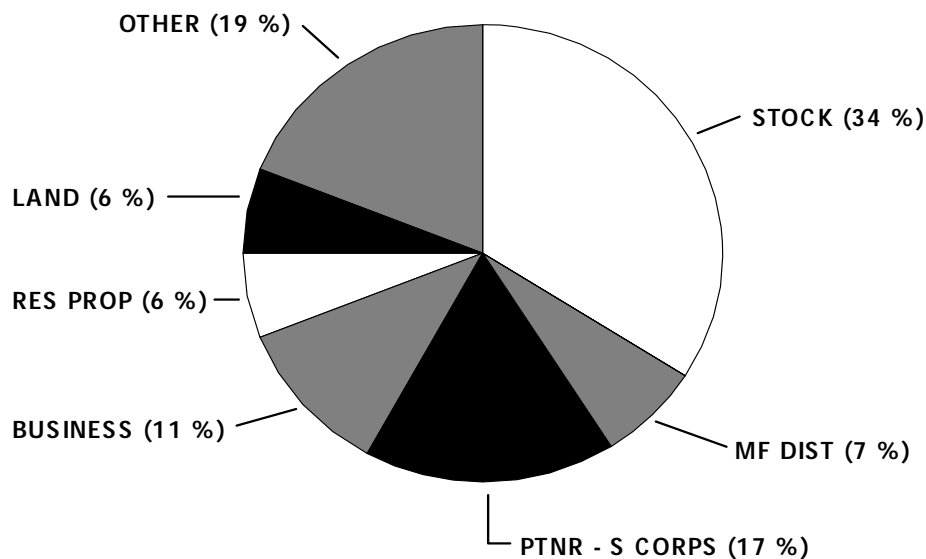
A Change in the Federal Capital Gains Tax Rate Will Increase State Revenues

The Taxpayer Relief Act of 1997 included a major change in the federal tax rate applied to gains from the sale of corporate stock, real estate, and other investment property. Most of these “capital” gains are now taxed at a maximum rate of 20 percent when held for more than 18 months, down from the 28 percent rate on sales completed through May. Up to \$500,000 of the net gains from the sale of personal residences is now totally exempt from tax. The recovery of excess depreciation on sale of other real estate is now taxed at a maximum rate of 25 percent.

Economists believe that the lower tax rate will encourage individuals to take profits on their investments more quickly, increasing the net capital gains income subject to the income tax. Since Minnesota’s tax rate on capital gains tax rate is unaffected by the federal change, Minnesota revenues are expected to increase.

Stock Market Gains Only Part of Capital Gains Revenues

Profits from the sale of corporate stock and mutual funds are the largest component of capital gains income, but they made up less than one half of all capital gains in 1993 according to a special sampling of returns by the U.S. Treasury Department. Sales of businesses, sales of residential and commercial real estate, and sales of business property also are significant parts of the capital gains tax base.

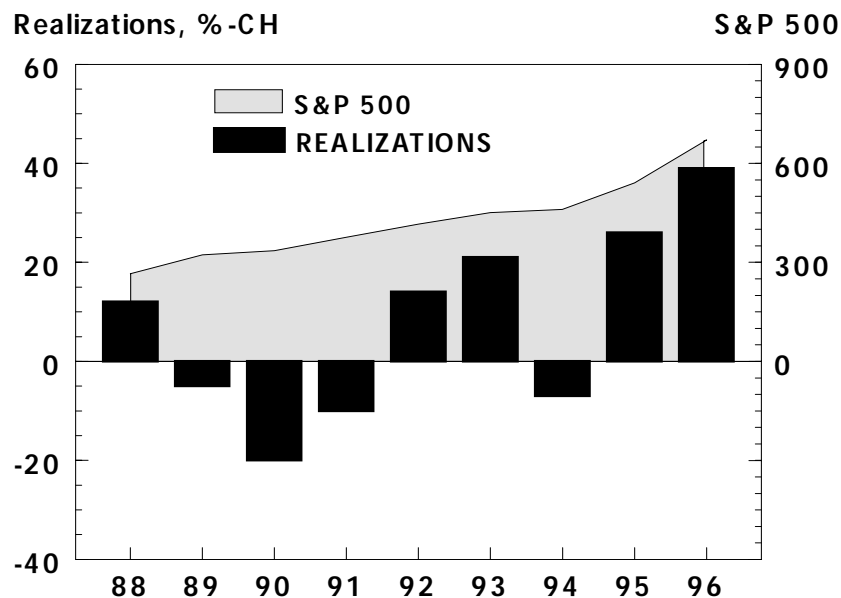


Stock Market Growth Not Always a Good Indicator of Change in Capital Gains

Net capital gains reported as taxable income by individual investors do not always increase when the stock market increases. In some years investors let more of their profits ride, while in others a greater proportion of the gains are realized. These changes in investor behavior make the capital gains component of individual income very volatile and difficult to forecast.

Since 1987 the Standard and Poor's 500 Index has increased every year. Net taxable capital gains, however, fell in 4 of the 9 years in that period. Preliminary data indicate that in tax year 1996 net capital gains as reported on the tax form grew by nearly 40 percent. For tax year 1995, growth was 25 percent.

Capital Gains Realizations More Volatile Than Stock Market



Capital Gains Model Indicates Further Growth in F.Y. 1998-99 Realizations

To estimate the amount capital gains are likely to add to future state income tax revenues, Department of Finance economists rely on a simple econometric model which relates the increase in taxable capital gains to the underlying growth in household wealth, and changes in inflation and in the real growth rate of the economy. Variables reflecting the maximum tax rate on capital gains and any change in the tax rate are also included, as is a variable designed to allow the estimates to move gradually toward an equilibrium value rather than adjust instantaneously to any shock.

The model was estimated using historical data from 1954 through 1996. The parameters of that model along with their significance levels are given below.

Variable	Coefficient
Tax Rate	-.045*
Rate Up	-.085
Rate Down	.018
Change log GDP	.114*
log Assets	.0023*
Change log Inflation	.134*
Dummy for 1986	.039*
Ratio(t-1)	.399*
<hr/>	
Adj. R-squared	.91
Durbin Watson	1.63

The dependent variable in the equation, the item estimated, is the ratio of U.S. wide net capital gains realizations to a measure of the aggregate of underlying wealth of U.S. households taken from the Flow of Funds accounts prepared by the Federal Reserve Board. Several variables are expressed in logarithms or as changes in logarithms. All starred variables are significant at the .005 level or better. Neither of the rate change variables were significant at conventional levels.

Future values for the key variables in the model, taken from DRI's November Control forecast, were used to forecast the growth in realization for tax years 1997, 1998, and 1999. In this forecast, taxable realizations are expected to increase by more than 25 percent in tax year 1997. The model indicates that the change in the federal tax rate on capital gains should add about \$150 million to the 1998-99 revenue forecast, an amount roughly consistent with the long-term impact of the tax change estimated by the Congressional Budget Office.

ISSUE HIGHLIGHT

Welfare Reform

Welfare Reform Dramatically Changes State-Federal Funding Relationships

With the enactment of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (federal welfare reform), the federal government significantly changed the way it funds state cash assistance and child care programs. Congress replaced the Aid to Families with Dependent Children (AFDC) entitlement program with the Temporary Assistance to Needy Families (TANF) block grant. Minnesota's equivalent of the TANF program is the Minnesota Family Investment Program (MFIP). Congress also consolidated several child care programs, including AFDC child care, into the Child Care and Development Fund (CCDF) block grant. In both cases, the entitlement status of the programs has ended, and federal spending is capped at the amount of the block grant.

While these reforms may provide states with greater flexibility in designing family support programs, the changes create new and complex financial requirements for state matching dollars. Specifically, states must maintain a maintenance of effort (MOE) equal to 80 percent of F.Y. 1994 spending levels. Failure to meet MOE standards results in a financial penalty for the state. For child care, the CCDF requires a state match for federal dollars in addition to the TANF matching requirements.

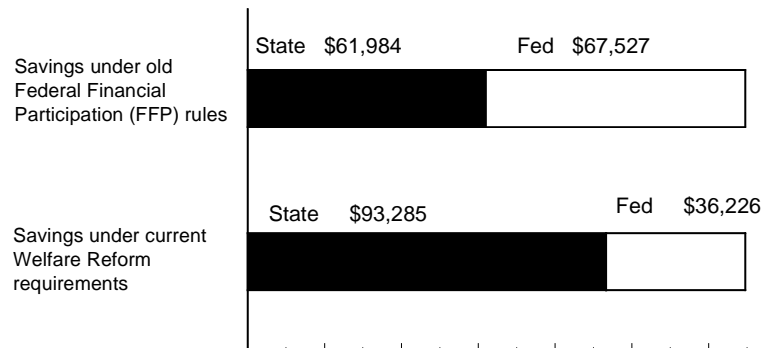
Prior to welfare reform, AFDC and the related child care programs were jointly funded by the states and federal government. The federal portion came in the form of a federally-determined rate of reimbursement called the federal financial participation rate (FFP). For Minnesota, the FFP rate has generally ranged between 51 and 54 percent.

The joint funding arrangement meant that any increase in costs would be split between the state and federal governments. Each dollar increase in program spending cost the state slightly less than 50 cents, with the federal government paying the remainder. Under the new TANF rules, the amount of federal funding in any given year is limited to the amount of the block grant. Consequently, any program costs above the combined spending of the MOE and the federal block grant must be borne entirely by the state.

Welfare Reform increases state share of MFIP forecast changes

MFIP Forecast Declines \$130 million over four years

F.Y. 1998-2001



This relationship also holds true when costs decrease, so that the \$130 million forecasted decline in the MFIP program benefits the state to a larger extent than would have been the case under the old FFP rules. As the graph indicates, in an FFP environment, savings would have been split between the state and federal governments, with the state receiving \$62 million of the \$130 million in savings. In the current environment, post-welfare reform, the state saves over \$93 million.

While this scenario works to the state's advantage when the program is shrinking, when costs rise, the state will be responsible for the entire increase. A reserve exists to mitigate some of these effects in the TANF program. Excess TANF block grant dollars not needed to meet current obligations are placed into a reserve in the U.S. Treasury. Because of declining welfare caseloads in Minnesota, the amount of this reserve is projected to reach \$65.4 million in F.Y. 1998. However, when program costs rise again, the reserve will be drawn down, leaving the state general fund solely responsible for the increased costs. If the TANF reserve is depleted, each dollar increase in program spending will cost the state a full dollar, rather than the almost 50 cent cost under previous matching rules.

A Shift in Spending Priorities At the State Level

Welfare reform in Minnesota has caused a major shift in spending priorities between two key family support programs: cash assistance and child care. In fact, while cash assistance spending is declining, increased child care costs more than outweigh those savings. This shift in funding represents a change in policy priorities as the state seeks to support low-income families not only through cash assistance, but also by providing incentives for work through non-cash support. The availability of affordable child care has long been viewed as a barrier to moving from welfare to work, particularly in single parent families.

As cash assistance recipients move into the workforce, it is likely that spending on the MFIP program will continue to decline while spending for subsidized child care will continue to rise. Many newly-employed MFIP recipients will likely need the support of the child care system to help move toward self-sufficiency.

Shifting State Family Support Spending November 1997 Forecast (\$ in millions)

	F.Y. 1996-97	F.Y. 1998-99	F.Y. 2000-01	F.Y. 2000-01 vs. F.Y. 1996-97
Cash Assistance (AFDC/MFIP)	\$286.2	\$206.7	\$137.4	(\$148.8)
Child Care Assistance*	\$76.4	\$205.8	\$295.3	\$218.9

*Child Care Assistance includes MFIP Child Care, Basic Sliding Fee Child Care, and child care development spending.

MFIP child care assistance is available to families who are participating in work or training activities while receiving cash assistance as well as for families who have moved off cash assistance within the past year. Additionally, the state provides child care subsidies on a sliding-fee basis to low-income families. The Basic Sliding Fee child care program supports those who have moved off welfare as well as those who have never received cash assistance. This program is designed to keep families from returning to welfare because of unaffordable child care.

F.Y. 1997 Year End Summary

F.Y. 1997 Actual Results Improve by \$364 million

Previous estimates for F.Y. 1997 projected a balance before reserves of \$1.631 billion at the close of the 1996-97 biennium. The actual ending balance was \$1.995 billion, \$364 million higher than forecast. The \$1.995 billion is the balance before subtracting total general fund reserves and appropriations carried forward to the next fiscal year.

F.Y. 1997 Forecast Change (\$ in millions)

Higher Revenues:

Major Taxes	\$234	
Other Revenues	31	
Transfers, Other	<u>7</u>	
Net Revenue Gain		272

Lower Spending:

Human Services	61	
All Other Spending	<u>31</u>	
Expenditure Savings		<u>92</u>

Forecast Change **\$364**

Less: Approp. Carried Fwd.	(38)
Increase to MnSCU Reserves	<u>(20)</u>

Net Forecast Change **\$306**

F.Y. 1997 Revenues Higher Than Forecast

Actual receipts for F.Y. 1997 exceeded end of session estimates for total general fund resources by \$272 million, or 1.4 percent. The individual income tax was the source of most of that additional revenue, with about 75 percent of the total variance coming from a combination of higher than anticipated settle-up payments for tax year 1996 and lower than expected individual income tax refunds. Variances for the other major revenue sources were small and well within historical levels.

Final federal individual income tax payments for tax year 1996 also were reported to be much higher than anticipated. Federal income tax payments exceeded the amount in the Treasury Department's February forecast by more than \$64 billion, or about 10 percent of final federal tax liability. Most states, including Minnesota, are reporting

similar results. In Minnesota, final income tax payments exceeded the forecast by about 5 percent, or \$206 million.

Only a portion of the data required to fully identify the sources of the additional tax liability is now available. That data indicates that much of the unexpected growth is due to higher than anticipated capital gains realizations in 1996. Preliminary analysis indicates that about \$60 million of the variance was one time, associated with the high level of merger and acquisition activity in Minnesota in 1996. Higher wages and the use of non-qualified stock options as part of compensation packages are suspected to have contributed to the unexpected surge in income tax revenues. Fiduciary payments were also higher. More complete data on the sources of the income that generated the additional Minnesota revenue will be available for use in preparing the February, 1998 forecast.

F.Y. 1997 Net Spending Lower Than Forecast

Actual spending for F.Y. 1997 was \$92 million lower at year end than previously forecast. However, \$38 million of this savings carried forward and will be spent in the current biennium, leaving a net expenditure change of \$54 million. An additional \$20 million increased the dedicated reserves of the Minnesota State Colleges and University (MnSCU) system. The increase to MnSCU reserves is caused by lower operating expenditures and higher non-tuition revenues than previously forecast. The current MnSCU reserve balance equals 12 percent of its system-wide F.Y. 1997 general fund expenditures.

Lower F.Y. 1997 Human Services Spending Benefits Bottom Line

Minnesota's strong economy had a greater impact on Department of Human Services (DHS) programs than projected. Lower than anticipated enrollments and decreased average payments contributed to the program savings. DHS expenditures for F.Y. 1997 were \$61 million lower than forecast. Net savings in the health care and family support programs contributed \$40 million of the change. Lower than anticipated spending in several non-forecast grant programs, combined with cancellations in Human Service's operating appropriations and an increase in Federal reimbursements for administrative expenses combined to generate the remaining savings.

F.Y. 1998-99 CURRENT BIENNIUM SUMMARY

Available General Fund Balance Now Forecast to be \$453 Million

Forecast revenues have increased by \$684 million for the 1998-99 biennium while projected expenditures have declined by \$256 million. When combined with a forecast increase in all other resources and the additional \$364 million increase in the balance from F.Y. 1997, the result is a forecast balance of \$1.360 billion at the end of the 1998-99 biennium.

Laws 1997, First Special Session, Chapter 4, Article 13 and M.S. 16A.152, Subdivision 2 provide for the allocation of positive unrestricted general fund balances forecast for the biennium. First, the education tax credits and deductions for tax year 1998 (\$81 million) take effect. Second, 60 percent of the balance plus interest is allocated to the Property Tax Reform account. Finally, the remainder becomes an unrestricted general fund balance. These actions will reduce forecast state income tax revenues by \$81 million for F.Y. 1999, increase the Property Tax Reform Account from \$46 million to \$872 million, and leave a projected available balance of \$453 million.

F.Y. 1998-99 BUDGET SUMMARY (in millions)

	End of Session Estimate	November Forecast	Change
Beginning Balance	\$1,631	\$1,995	\$364
Forecast Revenues	19,541	20,225	684
Other Resources	775	820	45
Estimated Expenditures	20,925	20,669	(256)
Cash Flow Account	350	350	--
Budget Reserve	522	522	--
Dedicated Reserves	72	93	21
Property Tax Reform Acct	46	46	--
Forecast Balance	\$32	\$1,360	\$1,328
Statutory Allocations:			
<i>Education Tax Credits/Deductions</i>	<i>na</i>	<i>81</i>	<i>81</i>
<i>Property Tax Reform Acct</i>	<i>na</i>	<i>767</i>	<i>767</i>
<i>Dedicated Interest</i>	<i>na</i>	<i>59</i>	<i>59</i>
Available Balance	\$32	\$453	\$ 421

A net increase of \$616 million in the four major taxes accounts for nearly all of the \$684

million increase in forecast tax revenues. Forecast changes for non-tax revenues, expected transfers from other funds and other resource items combined to yield a net forecast increase of \$45 million. As a result, current revenues and other resources for the biennium are expected to total \$21.045 billion, a \$729 million increase over estimates at the end of the 1997 Third Special Session.

A reduction in projected spending for the biennium also contributes to the favorable November forecast results. Total spending for the biennium is now estimated at \$20.669 billion. This is a \$256 million decrease (1.2 percent) from adopted budget estimates at the end of the legislative sessions.

Lower projected spending for the biennium is almost entirely the result of reduced estimates for human services spending, where the forecast is down \$302 million (5.9 percent) from end of session projections. The most significant decline occurred in forecast estimates of health care spending. F.Y. 1998-99 expenditures for health care programs, including Medical Assistance and General Assistance Medical Care and Chemical Dependency Treatment funds, were reduced a total of \$237 million from previous estimates. These forecast savings are primarily the result of the continued strong economy which has led to downward revisions of both projected caseload growth and costs per case.

The forecast also benefited slightly from reduced estimates of K-12 education spending. Total spending projections for education aids were reduced by \$33.0 million (0.05 percent) largely due to lower pupil unit estimates.

These decreases in estimated spending were, in part, offset by \$38 million in authorized appropriations carried forward from F.Y. 1997 at the close of the fiscal year.

Revenue Forecast

F.Y. 1998-99

Current general fund resources for the 1998-99 biennium are now expected to reach \$21.045 billion, \$729 million (3.6 percent), more than end-of-session estimates. Slightly more than one-half of the additional revenue reflects the carry forward of the higher receipts observed in F.Y. 1997. About one half of the remaining increase is attributable to revised projections of future capital gains realizations. A slight improvement in the economic outlook and an increase in expected investment income account for the balance of the new revenues.

Revenues from the four major taxes are expected to exceed previous estimates by \$616 million or 3.5 percent. The individual income tax accounts for nearly three-fourths of that additional revenue. Receipts from both the motor vehicle excise tax and the corporate income tax grow more rapidly than the individual income tax over the forecast horizon, but from a smaller base. Sales tax revenues were almost unchanged, decreasing by \$2 million or less than 0.05 percent from end of session estimates. Other tax and non-tax revenues were up by \$67 million.

F.Y. 1998-99 Revenue Forecast (\$ in millions)

	<u>FY96-97</u> <u>Biennium</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY98-99</u> <u>Biennium</u>
Revenues				
Individual Income Tax	8,904	4,361	5,118	9,479
Sales Tax	5,914	3,194	3,353	6,547
Corporate Income Tax	1,383	758	750	1,509
Motor Vehicle Excise Tax	<u>783</u>	<u>403</u>	<u>394</u>	<u>797</u>
Four Major Taxes	16,984	8,717	9,615	18,332
Other Revenues	<u>1,842</u>	<u>953</u>	<u>940</u>	<u>1,893</u>
Net Non-dedicated Revenue	18,826	9,670	10,555	20,225
Other Resources	<u>777</u>	<u>430</u>	<u>390</u>	<u>820</u>
Current Resources	<u>19,603</u>	<u>10,100</u>	<u>10,945</u>	<u>21,045</u>

Net non-dedicated revenues for 1998-99 are now projected to grow by 7.4 percent from F.Y. 1996-97 levels, after taking into account the \$500 million tax rebate approved during the 1997 legislative session. In the absence of that rebate, revenues would have increased by 10.1 percent. Biennial growth rates for the income tax and the sales tax are now expected to be 6.5 percent and 10.7 percent respectively.

Individual Income Tax

Individual income tax receipts are now expected to reach \$9.479 billion during the 1998-99 biennium, \$456 million (5.1 percent) more than end of session estimates. About 40 percent of the increase in the income tax forecast was the direct result of carrying forward the higher base from tax year 1996. Of the remaining 60 percent, just less than two-thirds came from increases in the expected rate of growth in the realization of capital gains and about 20 percent from stronger than previously expected wage growth. Changes in expected payments by fiduciaries, and increases in the forecast for pension income and taxable social security accounted for most of the remaining growth.

Behavioral impacts related to the recently enacted federal tax bill, other than those related to capital gains realizations, are not included in this forecast after consultation with the Department of Revenue and Legislative staff. Those impacts will be dealt with in the fiscal note for the 1998 Federal income tax update bill. Income tax receipts are reported prior to the reductions for education tax credits and deductions enacted in the June 1997 special session, which were dependent on the final balance of this forecast. Those credits and deductions would reduce the forecast by \$81 million in F.Y. 1999.

Not all of the projected variance in tax year 1996 individual income tax liability was added to the base and extended to 1997, 1998, and 1999. The level of merger and acquisition activity in Minnesota during the 1996 tax year was well above historical levels, generating gains that substantially exceeded those expected in a normal year. Only the increase in what were considered to be normal realizations was added to the base level of capital gains used in the forecast of future tax liabilities. It now appears that up to one-third of the variance in tax year 1996 income tax liability may have been one-time revenues related to mergers and acquisitions.

Preliminary federal return data suggest that the stock market's strong performance during 1996 boosted capital gains realizations substantially from the prior years. This forecast assumes capital gains in Minnesota grew at just under a 40 percent rate in 1996. That growth rate is consistent with the national growth rate currently assumed by the Congressional Budget Office. It is also consistent with the overall growth in individual income tax liability observed for tax year 1996. Minnesota specific information on last year's increase in net capital gains realizations will be available when the annual sample of Minnesota filers is completed in late January. February's forecast will reflect that actual 1996 Minnesota experience. This forecast also assumes that the strong growth in realizations observed in 1996 was not caused by a one-time acceleration of future capital asset sales.

Uncertainty about taxpayer response to recently enacted reductions in the federal capital gains tax rate increases the risk to the forecast for tax years 1997, 1998, and 1999. Other things equal, a lower capital gains tax rate is expected to encourage investors to turn over their holdings of capital assets more frequently since the proportion of one's profits lost to taxes will be less than in the past. Some also believe

that the lower rate will produce a substantial one time surge of realizations as individuals whose portfolios have become overly concentrated in one stock or a certain asset class take advantage of the lower tax cost of diversifying their holdings. The Department of Finance's econometric analyses of the effect of past changes in the capital gains tax rate on realizations offered considerable support for the belief that tax rates affect the long term level of capital gains realizations. No empirical evidence was found to support the hypothesis that a one-time surge in realizations would occur, which would further add to the long term increase. This forecast makes no special provisions for additional revenues due to "unlocking" gains from long time portfolio holdings.

The combination of the large increase in tax year 1996 capital gains realizations and the possibility of large one-time growth in realizations following the passage of capital gains tax relief creates the potential for large revisions to the individual income tax forecast in February. Should fourth quarter estimated income tax payments, due January 15, 1998, be substantially above or below current projections, material changes to the forecast are likely.

Retirement related incomes--pensions, social security, and IRA distributions--are also expected to grow more rapidly than in the past. As the population ages, an increasing number of filers are reporting retirement income. Strong stock market growth is increasing the value of IRAs and defined contribution pension plans, and recent changes in the state pension system are likely to significantly increase pension payouts. Public employee pension payments are expected to grow substantially due to two factors: a one time benefit increase for current retirees in exchange for an actuarially equivalent reduction to future, lifetime cost of living adjustments, and significant benefit increases based on the performance of the investment portfolio. Higher average levels of taxable pension income also result in a higher proportion of social security income subject to tax.

Projected wage growth for the 1998-99 biennium was raised slightly from February's estimates. In addition, data on Minnesota wages paid during 1996 were revised, adding about \$500 million to the wage base. Wage growth during the current biennium averages just over 5 percent per year, up by roughly 0.5 percent from February's forecast.

Receipts from fiduciary returns continued substantially above historical levels in 1996. The forecast now assumes that receipts stay at these levels through the entire forecast horizon. Withholding receipts in excess of withholding claimed was increased by \$8 million per year to be consistent with past observations.

Replacing the 1994 income tax filer sample with a sample of 1995 filers made no material difference in estimated tax liability.

Sales Tax

Net sales tax receipts are expected to total \$6.547 billion during the 1998-99 biennium, down \$2 million (0.03 percent), from end of session estimates. Projected stronger growth in spending for consumer durables and producers durable equipment was offset by slower growth in other components of the sales tax base leaving little change in the expected level of sales tax receipts for the current biennium. The receipts elasticity with respect to the simulated base was reduced to .95 from 1.0 to reflect a slight but persistent over forecasting by the sales tax model during the past 4 quarters. Expected sales tax refunds increased by \$7 million over February's estimate. Through October gross receipts during the 1998 fiscal year have been within 0.4 percent of the forecast.

Corporate Income Tax

Expected corporate income tax revenues for the 1998-99 biennium are now forecast to reach \$1.509 billion, up \$100 million (7.1 percent) from end of session estimates. An upward revision to the historical corporate profit data series coupled with stronger than anticipated growth in corporate profits in fiscal 1997 combined to produce this increase. The 1998 F.Y. to date variance of \$23 million was incorporated into the new forecast. The corporate income tax remains the most volatile of all the major revenues.

Corporate refunds required under the Cambridge Bank decision are treated as expenditures from the Cambridge Settlement Fund, not netted against current corporate income tax receipts. A total of \$204 million in Cambridge related refunds have now been paid, about 95 percent of current estimates of liability. Several refund decisions are now under litigation. Settlement of that litigation could add materially to the expected final liability.

Motor Vehicle Excise Tax

Motor vehicle excise taxes are now projected at \$797 million for the 1998-99 biennium, \$63 million (8.5 percent) above prior projections. F.Y. 1998 receipts through October were \$31 million (25 percent) above forecast. That variance is included in the forecast. Auto sales have substantially exceeded February's forecast levels since the start of the fiscal year, and DRI estimates spending on autos and light trucks will remain relatively constant over the remainder of the biennium.

Analysis of the quarterly pattern of receipts indicates what appears to be a recurring pattern where motor vehicle tax receipts exceed forecast during the second quarter of the calendar year. The additional revenues do not appear to be simply a timing change, with receipts borrowed from other quarters, but instead may indicate a more fundamental change in the structure of the relationships between motor vehicle excise tax receipts and the national income accounts estimates of auto sales to consumers. This issue will be investigated further in conjunction with the February forecast.

Other Revenues

Other tax and non-tax revenues are expected to total \$1.893 billion for the 1998-99 biennium, up \$67 million, (3.8 percent) from end of session estimates. Investment income was increased by \$86 million from end of session estimates, reflecting the larger cash balances projected for the current biennium. The forecast of mortgage and deed tax receipts was increased by \$19 million consistent with the current positive variance and reflecting an expected increase in the value of homes sold and an increase in the number of home mortgage refinancings during the next six months. These increases were offset in part by reductions in the forecast for the healthcare provider tax, lawful gambling taxes, and revenues collected at DHS regional treatment centers.

F.Y. 1998-99 Expenditure Forecast

The November 1997 expenditure forecast for the 1998-99 biennium totals \$20.669 billion, a \$256 million decrease from estimates at the end of the 1997 legislative sessions. Decreases in projected spending for health and human services programs and local aid programs offset relatively minor increases in spending in other areas and appropriations carried forward from the previous biennium.

F.Y. 1998-99 GENERAL FUND SPENDING (\$ in millions)

	<u>End of Session</u>	<u>November Forecast</u>	<u>Difference</u>
Spending by Function:			
Education/Children & Families	\$6,885	\$6,852	(\$33)
Property Tax Recognition	\$19	\$19	\$0
Post-Secondary Education	\$2,370	\$2,377	\$7
Property Tax Aids & Credits	\$2,611	\$2,590	(\$21)
Other Major Local Assistance	\$1,001	\$980	(\$21)
Health Care	\$3,572	\$3,335	(\$237)
Family Support	\$585	\$553	(\$32)
State Operated Institutions	\$893	\$892	(\$1)
Legislature, Judicial, Const. Officers	\$478	\$485	\$7
State Agencies' Operations & Grants	\$1,707	\$1,731	\$24
Debt Service	\$582	\$581	(\$1)
Estimated Cancellations	(\$20)	(\$20)	\$0
Subtotal-Major Spending Categories	\$20,683	\$20,375	(\$308)
Dedicated Expenditures	\$242	\$294	\$52
Total Expenditures & Transfers	\$20,925	\$20,669	(\$256)

Education and Children & Family Spending Decreases by \$33 Million

State spending for education and children & family programs is projected to decrease \$33 million from end of session estimates. Savings across all education programs totaled \$38 million, and as permitted by current law, these savings are redistributed to programs with deficiencies as needed. The forecast estimates that \$6 million is needed to cover the deficiencies, and after other minor adjustments of \$1 million, a net reduction of \$33 million remains. With these changes, total spending on education and children & family programs is projected at \$6.852 billion for the 1998-99 biennium.

Statewide enrollment figures are projected to be fairly constant over the next several years. Current growth rates of less than one percent will fall to nearly zero by F.Y. 2001. This forecast reduces pupil projections downwards by 1,236 students over the biennium, bringing the average daily membership projection to 852,976 pupils by the 1998-1999 school year.

The general education program provides school districts with basic operating funds. Revenue is allocated to districts based on enrollment and several demographic characteristics. The drop in pupil units accounts for \$8 million of the decline in obligations for the general education program. Reductions due to 1997 pension changes were \$2 million less than estimated at the end of session. This change, combined with other small adjustments, results in a net general education decrease of \$12 million.

The largest decreases in categorical aid, which districts receive for specific activities or populations, are a \$15 million decrease in the special education excess cost program, and a \$5 million decrease in debt service aid.

Post-Secondary Education Spending Increases Slightly

Post Secondary education spending (including direct and open appropriations) is \$7 million above end-of-session estimates. \$4 million of this amount is attributable to F.Y. 1997 appropriations for technology and other special purposes carried forward by MnSCU, and \$2 million reflects an increase in the amount of interest MnSCU is forecast to earn on dedicated receipts balances. Actual pension savings reductions to appropriations for MnSCU and the University of Minnesota were \$1 million below estimates made at the end of session, accounting for the remainder of the forecast variance.

Student enrollment is expected to stabilize at both state higher education systems. MnSCU's full-year equivalent student enrollment fell by 1 percent from 1996 to 1997, while the University of Minnesota posted an enrollment decline of 2.4 percent. Both systems forecast stable or slightly increasing enrollments during the 1998-1999 biennium. Total tuition revenue in the first year is expected to rise at about the rate of inflation, 2.6 percent for the MnSCU system and 2.7 percent for the University of Minnesota.

Property Tax Aids & Credits Estimates Drop \$21 Million

Estimated property tax aids and credit expenditures decreased by \$21 million for F.Y. 1998-99. The largest change occurred in property tax refunds that are now forecast to be \$14 million lower than end-of-session estimates. An \$11 million reduction resulted from elimination of the shift cost associated with the new Education Homestead Credit that did not materialize due to other law changes. Other declines occurred in Police State Aid (\$3 million) and Disparity Reduction Aid (\$2 million). These decreases were partially off-set by increases in Homestead and Agricultural Credit Aid (\$6.1 million), the Regional Transit Board levy reduction (\$1.7 million), and other small changes.

Lower Housing Program Costs Reduce Other Major Local Assistance Spending

Other major local assistance program spending estimates for F.Y. 1998-99 drop by \$21

million in this forecast. A \$3 million projected increase in criminal justice assistance is offset by almost \$24 million in reduced spending in other areas, primarily human services grant programs.

Most of the human services reduction is in the forecast for the Group Residential Housing (GRH) program in the Department of Human Services. New analysis of the impact of recent federal law changes generated nearly all the \$18 million cost savings found in the GRH forecast. In the past year, Congress eliminated Supplemental Security Income (SSI) benefits for drug-and-alcohol-addicted persons. At the end of session, it was expected that about 900 people in GRH facilities would lose federal supplements, leading to increased state costs. However, as the benefit review takes place, it appears that only 150 people will actually lose income, since many current residents of GRH facilities are still able to retain SSI benefits due to other disabilities.

Health Care Program Cost Projections Fall \$237 Million

State expenditures for health care in F.Y. 1998-99 are down \$237 million from end of session projections. Strong economic conditions are keeping caseloads down in nearly every category, and changes in the average costs of serving some segments of the population are also responsible for some forecast savings.

F.Y. 1998-99 Health Care Spending by Program (in millions)

	End of Session	Nov. 1997 Forecast	Difference
Medical Assistance			
Long Term Care Facilities	\$1,168	\$1,145	(\$23)
Long Term Care Waivers	\$549	\$526	(\$23)
Aged & Disabled Basic Care	\$742	\$676	(\$66)
MFIP & Families Basic Care	\$693	\$622	(\$71)
General Assistance Medical Care	\$344	\$297	(\$47)
Chemical Dependency	\$75	\$68	(\$7)
Total	\$3,572	\$3,335	(\$237)

The greatest caseload declines are found in the programs serving low-income families: Medical Assistance (MA) Basic Care and General Assistance Medical Care (GAMC). Costs have decreased by \$118 million from end of session estimates in the two health care programs serving this population.

The MFIP and Families Basic Care program produces \$71 million of the savings. A 2.0 percent decrease in caseload saves \$37 million, lower average costs for MFIP-S enrollees accounts for \$33 million, with \$1 million in other adjustments. GAMC savings since the last forecast total \$47 million, with \$24 million attributable to caseload

decreases of 13.0 percent from earlier projections. An additional \$8 million is due to an accounting shift that recognizes past law changes and moves the cost of care for pregnant women and children under two years of age from the General Fund to the Health Care Access Fund. Other changes net to \$15 million.

The strong economy also is reducing state obligations for services to the elderly and disabled, with the effects seen in three MA categories: long-term care facilities, long-term care waivers, and aged & disabled basic care. These programs are less sensitive to economic conditions than those discussed above, due to a more limited set of options. However, with the higher cost associated with serving the elderly and disabled, relatively small caseload changes can still result in significant changes in program costs. The strong economy seems to affect caseloads by improving the ability of the elderly to pay for a greater share of health care costs with their own resources, and increasing the accessibility and availability of other health care options.

Decreases in these three programs, compared to end of session estimates, total \$112 million. Major elements of the change include:

- a \$48 million decrease due to basic care cost savings and caseload declines;
- a \$38 million reduction due to a 2.0 percent decline in nursing facility caseloads;
- a \$12 million increase due to a lower federal match for state health expenditures in these programs;
- a \$10 million decline due to a delay in shifting people onto the MA waiver program from the Alternative Care program;
- a \$37 million decrease in the projected average cost for providing basic health care to disabled persons; and
- other adjustments which net to an increase of \$8 million.

Estimates for the Chemical Dependency (CD) entitlement program have also decreased by \$7 million since the end of session as more people obtain CD services through managed care plans and move off this program.

Family Support Program Costs Drop \$32 Million

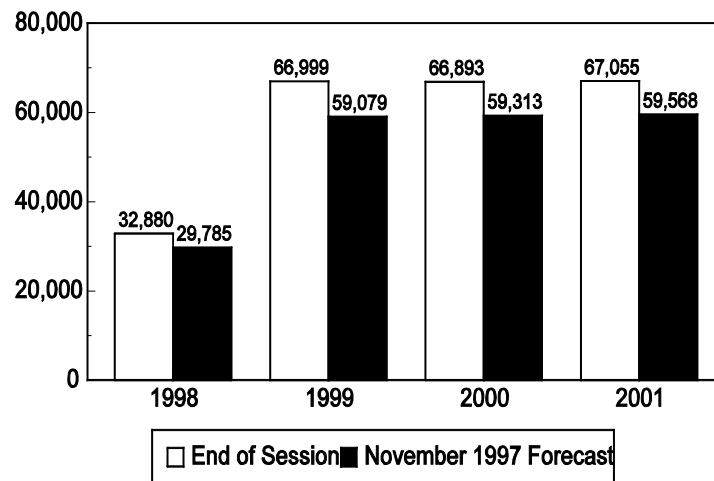
Family support spending is projected to be \$32 million less than end-of-session estimates, a decrease of 5.5 percent. With these changes, family support spending will total \$553 million for F.Y. 1998-99. Low unemployment, coupled with publicity on welfare reform, has significantly driven down caseloads in the Minnesota Family Investment Plan (MFIP), which replaced Aid to Families with Dependent Children (AFDC) in Minnesota. Caseloads in the General Assistance program are also forecast to decline.

Family Support Savings by Program
End of Session - November
(\$in millions)

	<u>F.Y. 1998</u>	<u>F.Y. 1999</u>	<u>Biennium</u>
Aid to Families with Dependent Children / Minnesota Family Investment Plan	\$0	(\$20)	(\$20)
General Assistance (GA)	(\$7)	(\$6)	(\$13)
Minnesota Supplemental Aid	(\$2)	(\$3)	(\$5)
Child Care Assistance	(\$12)	\$18	\$6
Total	(\$21)	(\$11)	(\$32)

State spending for AFDC/MFIP is forecast to decrease \$20 million (9.8 percent) for F.Y. 1998-99 from end-of-session estimates. Total spending for these programs is projected at \$207 million for F.Y. 1998-99. Full statewide implementation of the MFIP program is scheduled to begin January 1, 1998, the midpoint of the state's 1998 fiscal year. The lack of general fund savings in F.Y. 1998 does not reflect overall caseload declines, but rather, reflects minimum state spending needed to meet new federal matching requirements.

MFIP Caseload Estimates



General Assistance spending is expected to be \$13 million lower than earlier estimates due to the same economic factors driving down AFDC/MFIP costs. The decline in the GA forecast also reflects the effect of the restoration of federal Supplemental Security Income (SSI) benefits for legal non-citizens. While the 1997 Legislature had appropriated \$16 million to cover benefits for legal non-citizens who were losing

eligibility due to federal welfare reform, Congress' restoration of benefits to this population means additional financial support will not be needed in the GA program. The SSI decreases do not translate into general fund savings, however, because the 1997 Legislature directed these funds into an MFIP/TANF reserve.

The state has two major child care assistance programs: the MFIP child care program, providing child care to MFIP recipients and families who have recently moved off MFIP; and the Basic Sliding Fee program, for low-income families not on cash assistance. State spending for the MFIP child care program is expected to increase by \$6 million over appropriated amounts for F.Y. 1998-99. This figure reflects the net effect of a \$12 million decrease in F.Y. 1998 and an \$18 million increase in F.Y. 1999, due to the realignment of appropriated amounts with anticipated expenditures.

Looking forward, as families move from MFIP into the workforce, the demand for child care assistance is expected to increase substantially. Because families are eligible for child care assistance for up to one year after leaving MFIP, child care expenditures are projected to increase even as MFIP caseloads decline.

Debt Service Estimates Reduced

General fund debt service for the 1998-99 biennium is estimated to be \$581 million, a \$1 million decrease from end of session estimates. This is the estimated amount needed during the 1998-99 biennium to fund debt service associated with outstanding general obligation bonds, new bonds to be sold for currently authorized projects and a projected capital budget of \$500 million in the 1998 legislative session.

The F.Y. 1998-99 debt service estimate is based on bond sales in May and October, 1998. The interest rates for the bond sales are based on DRI forecast rates of 4.8 percent and 4.7 percent for the respective sales. The size of the bond sales are based on agencies' cash flow estimates as of November, 1997.

All Other Spending Shows Little Net Change

The forecast for all other areas does not change significantly from end of session estimates. Spending for most state agency operations and miscellaneous grant programs is fixed by state appropriations made in the 1997 regular legislative session. Total spending for state institutions, the legislative, judicial, and constitutional officers, and state agencies is currently projected to increase by approximately \$30 million from end of session estimates. Authorized carryforward of F.Y. 1997 appropriations and a variety of technical adjustments to selected programs account for the total net change in projected spending.

FOUR YEAR PLANNING HORIZON

F.Y. 2000-01 Budget Planning Estimates

The November, 1997 forecast includes planning projections for next biennium, F.Y. 2000-01. These projections are materially different from the budget forecast for the current biennium. The distinction is based primarily on the difference in approach and assumed greater accuracy of shorter term forecasting (1998-99).

F.Y. 2000-01 revenue projections are based on DRI's Summer 1997 Cycle and November, 1997 Control forecasts. Expenditure estimates include discretionary inflation increases of 2.5 percent per year.

F.Y. 2000-01 Planning Estimates

(\$ in millions)

	<u>F.Y. 1998-99</u>	<u>F.Y. 2000-01</u>	<u>Difference</u>	
Beginning Balance	\$1,995	\$2,289	\$294	
Revenues	\$21,045	\$23,191	\$2,146	+10.2%
Education Tax Credits	(\$81)	(\$171)	(\$90)	
Expenditures	\$20,669	\$22,220	\$1,551	+7.5%
Cash Flow Account	\$350	\$350	\$0	
Budget Reserve	\$522	\$522	\$0	
Property Tax Reform Acct	\$872	\$872	\$0	
Dedicated Reserves	\$93	\$61	(\$32)	
Ending Balance	\$453	\$1,284	\$831	

Planning estimates of current law revenues and expenditures for F.Y. 2000-01 are presented as part of budget development to identify longer term issues. Revenue forecasts are based on DRI long term forecasts for the 2000-01 period. Expenditure projections assume current laws and policies will continue unchanged. Expenditure estimates for F.Y. 2000-01 consider caseload, enrollment, and other forecast variables in all major program areas. The estimates do not reflect possible Governor's supplemental budget recommendations.

Current law repeals the major components of education finance effective June 30, 1999. Because the state constitution requires that the state provides a "fair and uniform" education, the forecast assumes that education services will be provided in some form. Planning estimates reflect the continuation of existing programs and policies.

The planning estimates also assume that the Property Tax Reform Account remains at F.Y. 1999 levels.

Higher Revenues, Lower Spending Improve 2000-01 Structural Balance

The focus of long-range planning estimates has been on the State's *structural balance* (current year revenues and expenditures, excluding balances from prior years). A significant improvement from planning estimates made at the end of the 1997 legislative sessions is primarily result of:

- revenue increases of \$713 million
- revenue decreases of \$171 million reflecting enacted education tax credits
- reduced spending totaling \$233 million

Revenue changes for F.Y. 2000-01 largely reflect the higher base levels being forecast for 1998-99. Expenditure savings are largely reflected in reduced spending estimates for health care and family support programs.

F.Y. 2000-01 Planning Estimates Change from End of Session Estimates (\$ in millions)

	<u>End of Session</u>	<u>Nov. 1997</u>	<u>Difference</u>
Beginning Balance	\$1,022	\$2,289	\$1,267
Revenues	\$22,478	\$23,191	\$713
Education Tax Credits	\$0	(\$171)	(\$171)
Expenditures	<u>\$22,453</u>	<u>\$22,220</u>	<u>(\$233)</u>
Structural Balance	\$25	\$800	\$775
Cash Flow Account	\$350	\$350	\$0
Budget Reserve	\$522	\$522	\$0
Property Tax Reform Acct	\$46	\$872	\$826
Dedicated Reserves	<u>\$72</u>	<u>\$61</u>	<u>(\$11)</u>
Ending Balance	\$57	\$1,284	\$1,227

The projections are not intended to predict with any certainty balanced or unbalanced budgets in the future. The purpose is to assist analysis of how well future projected revenues and expenditures will match based on trend projections of Minnesota's economy and the current structure of government services. As the Governor and Legislature consider and adopt program and funding changes, they are required to make the necessary decisions to keep the state's budget balanced.

Revenue Planning Estimates

F.Y. 2000-01

Current resources for the 2000-01 biennium are now projected to total \$23.191 billion, 10.2 percent more than the 1998-99 forecast. The 2000-01 planning estimate is \$713 million, (3.2 percent) more than the end-of-session estimate. The four major taxes are expected to grow by 12.4 percent, while other tax and non tax revenues are projected to decline by 4.5 percent. Other dedicated revenues transfers and adjustments fall by a combined \$48 million from projected 1998-99 levels.

As with the F.Y. 1998-99 revenue forecast, all behavioral impacts of the recently enacted federal tax bill except for those related to capital gains are excluded from the planning estimates. The Department of Finance, the Department of Revenue and Legislative Staff have agreed that those impacts would best be dealt with in the estimates made for the federal update bill. Revenues reported are those prior to the education credits and deductions enacted in the June 1997 Special Session which were contingent on the results of the November forecast. Recognition of those credits and deductions reduces revenues by \$84 million in 2000 and by \$87 million in 2001.

This baseline planning estimate is not an explicit forecast. It is simply an extrapolation of projected trends in the economy. Because of the way it is constructed, any changes in the base level of revenues for fiscal 1998 or fiscal 1999 will be reflected in the planning estimates for 2000 and 2001. Other things equal, stronger than anticipated growth in either of those years will add significantly to revenues available in the 2000-01 biennium. Similarly, should the economy grow more slowly than forecast during the next two years, the revenue outlook for 2000-01 will deteriorate.

These revenue planning estimates are only a guide to the level of future revenues, not a guarantee. If the economy remains strong through 1999, and if capital gains realizations projected for tax years 1997 and 1998 are accurate, the planning estimates are likely to underestimate future revenues. But if the economy fails to perform at the high level anticipated in the DRI November Control, or, if capital gains realizations fail to reach the level projected, the planning estimates will overstate future revenues. Actual revenues could exceed or fall short of these estimates by as much as \$1.5 billion, depending on the economy's performance during the next 3 ½ years.

The projected growth rate for F.Y. 2000-01 revenues exceeds that forecast for the 1998-99 biennium. Revenue growth rates in the 1998-99 biennium were unusually low because of several one time events which affected tax liabilities in F.Y. 1997 and because of the one time property tax rebate which was provided through the income tax system. When compared to actual growth rates in previous biennia, revenue growth in 2001-2002 is slightly slower than average.

F.Y. 2000-01 Revenue Planning Estimates (\$ in millions)

	<u>FY98-99 Biennium</u>	<u>FY00</u>	<u>FY 01</u>	<u>FY2000-01 Biennium</u>
Revenues				
Individual Income Tax	9,479	5,393	5,634	11,027
Sales Tax	6,547	3,507	3,656	7,163
Corporate Income Tax	1,509	776	826	1,603
Motor Vehicle Excise Tax	<u>797</u>	<u>403</u>	<u>415</u>	<u>818</u>
Four Major Taxes	18,332	10,079	10,531	20,610
Other Revenues	<u>1,893</u>	<u>900</u>	<u>909</u>	<u>1,809</u>
Net Non-dedicated Revenue	20,225	10,979	11,440	22,419
Other Resources	<u>820</u>	<u>368</u>	<u>404</u>	<u>722</u>
Current Resources	<u>21,046</u>	<u>11,347</u>	<u>11,844</u>	<u>23,191</u>

Estimates of 2000-01 revenues are based on DRI's Summer 1997 Cycle and November, 1997, Control forecasts. Nominal growth rates for 2001 for key variables used in projecting tax revenues are based on the values for those variables in the November Control scenario. For 2001, the growth rates were computed by multiplying the appropriate inflation estimate for the year in question from the November Control forecast by the average real growth rate for the series computed over the entire 25 year Cycle forecast horizon.

In October, 1996 DRI extended the forecast horizon for its Control forecast to 5 years. There is, however, no history on the reliability of the four and five year Control forecast. The Department of Finance has chosen to continue use of its current methodology for preparing revenue planning estimates. Department economists will evaluate the DRI Control's year four and year five projections throughout the coming biennium and, after consultation with the Council of Economic Advisors decide whether they should become the base for the long term planning estimates in November 1998.

Individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth in the Cycle forecast. All elements of taxable income and all individual itemized deductions were assumed to grow at the rate of DRI forecast for taxable personal income. As in the 1998-99 biennium, lower projected inflation rates increased expected income tax receipts through lower indexing.

Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 1999.

Future sales tax revenues were estimated by computing percentage growth rates for each of seven broad categories of products in the sales tax base. Those growth rates for 2000 were based on the November Control. For 2001, the estimated real growth from DRI's Summer, 1997 Cycle forecast and inflation from the November, 1997, Control forecast were used. The growth rates were then weighted by the fraction of the expected 1999 sales tax base attributable to each category of purchases. The sum of the weighted growth rates was used as a measure of expected growth in the sales tax base for 2000 and 2001. Stronger real growth in the sales tax base was offset almost entirely by lower projections for inflation.

Corporate tax receipts in Minnesota were estimated to grow at the same rate as the DRI's forecast of national before tax corporate profits. Minnesota's motor vehicle excise tax collections are expected to grow at the same rate as the national consumption of motor vehicles and parts. Planning estimates for other tax and non tax revenues were prepared by extrapolating existing trends.

It is impossible to anticipate the economy's performance four or five years in advance. Economic projections that far into the future can only be extrapolations of historical trends consistent with the current short term outlook. It is important to remember that the long term revenue planning estimate is only a guide to what revenues four and five years from now might be, not a guarantee of a specific level of revenues, and that there can be large positive or negative errors in that long term estimate.

F.Y. 2000-01 Expenditure Projections

Forecast expenditures for the F.Y. 2000-01 biennium total \$22.220 billion, a 7.5 percent increase over the F.Y. 1998-99 biennium. These "planning estimates" are projections of the cost of continuing current law programs after adjusting for changes in education enrollment, caseloads in human service programs and correctional institutions, net tax capacity, and number of households.

The planning estimates provide for a 2.5 percent annual increase in the cost of goods, services and major state grant programs for F.Y. 2000-01. This *discretionary* inflation (\$779 million) is not required by current law, but reflects the impact of expected price increases on the cost of government operations.

The F.Y. 2000-01 planning estimates contain two methodology changes from previous estimates. First, inflation has been calculated on all programs except for debt service and dedicated expenditures. Previously, property tax aids & credits and non-health & human services grant programs were excluded in the calculation. The new method is simpler and is expected to be more useful for users of the forecast information. Secondly, the inflation rate applied has been reduced from 3.0 percent to 2.5 percent per year, based on lower projected inflation in the DRI forecast.

F.Y. 2000-01 Planning Estimates (\$ in millions)

	Forecast Base F.Y. 2000-01	Discretionary Inflation	Total F.Y. 2000-01
Spending by Function:			
Education/Children & Families	\$7,107	\$269	\$7,375
Post-Secondary Education	\$2,315	\$87	\$2,402
Property Tax Aids & Credits	\$2,784	\$106	\$2,890
Other Major Local Assistance	\$1,006	\$38	\$1,044
Health Care	\$3,826	\$146	\$3,972
Family Support	\$552	\$21	\$573
State Operated Institutions	\$920	\$35	\$955
Legislature, Judicial, Const. Off.	\$504	\$19	\$523
State Agencies Ops & Grants	\$1,561	\$58	\$1,618
Debt Service and Other	\$608	\$0	\$608
Estimated Cancellations	(\$20)	\$0	(\$20)
Subtotal	\$21,162	\$779	\$21,941
Dedicated Expenditures	\$279	\$0	\$279
Total Spending	\$21,441	\$779	\$22,220

Planning estimates for the F.Y. 2000-01 biennium show a growth of \$1.551 billion over forecast spending for the F.Y. 1998-99 biennium.

2000-01 EXPENDITURE PROJECTIONS
(\$ in millions)

	Forecast F.Y. 1998-99	Plng. Est F.Y. 2000-01	Change	
			\$	%
Education/Children & Families	\$6,852	\$7,375	\$523	7.6%
Property Tax Recognition	\$19	\$0	(\$19)	-100.0%
Post-Secondary Education	\$2,377	\$2,402	\$25	1.1%
Property Tax Aids & Credits	\$2,590	\$2,890	\$300	11.6%
Other Major Local Assistance	\$980	\$1,044	\$64	6.5%
Health Care	\$3,335	\$3,972	\$637	19.1%
Family Support	\$553	\$574	\$21	3.8%
State Operated Institutions	\$892	\$955	\$63	7.1%
Legislature, Judicial, Const.	\$485	\$523	\$38	7.9%
State Agencies	\$1,731	\$1,618	(\$113)	-6.5%
Debt Service	\$581	\$608	\$27	4.6%
Estimated Cancellations	(\$20)	(\$20)	\$0	0.0%
Subtotal	\$20,375	\$21,941	\$1,566	7.7%
Dedicated Expenditures	\$294	\$279	(\$15)	-5.3%
Total Spending	\$20,669	\$22,220	\$1,551	7.5%

School Funding Laws Repealed Effective F.Y. 2000; Forecast Assumes Spending Growth Consistent with Current System

While this forecast assumes the continuation of existing programs for planning purposes, Laws 1992, Chapter 499, repeals the major components of general education revenue and referendum revenue effective June 30, 1999. This includes the basic general education and referendum levies for FY 2000 (the 1999-2000 school year) which are computed in the fall of 1998. If action is not taken by the 1998 Legislature to either reinstate these levies or replace them with an alternative levy model, school levies for F.Y. 2000 will be reduced by \$1.6 billion. While this scenario leaves all school districts facing an uncertain funding future in FY 2000-01, referendum districts will need to grapple with the effect of the repealer in the current biennium due to the 31 percent shifting of the referendum levy.

Under the assumption of continuing programs, the planning estimates for education and children & family program spending total \$7.376 billion, an increase of \$523 million (7.6 percent) over the current biennium. This includes \$269 million in potential discretionary inflation and a net increase of \$254 million due to a lengthy list of programmatic changes. After accounting for shifts between categorical aid

and general education programs, the major changes include:

- (1) an increase of \$59 million due to growth in the number of pupils;
- (2) an increase of \$106 million due to provisions of the 1997 Omnibus Tax Bill which increased state education aid to buy down property tax levies;
- (3) an increase of \$76 million due to the \$79 per pupil unit increase in the general education formula allowance from FY 1998 to FY 1999;
- (4) a \$14 million increase in compensatory education obligations;
- (5) a decrease of \$49 million due to the modified training and experience formula;
- (6) a net decrease in the general education program of \$6 million due to changes in levies, referenda and final payments;
- (7) an increase of \$132 million in special education and excess cost programs due to the continued roll-in of school HACA; and
- (8) a decrease of \$125 million due to non-recurring programs in FY 1998-99, especially in technology programs; and
- (9) \$47 million increase in other net adjustments.

Pupil unit estimates for the FY 2001 forecast were adjusted for grades 10 and 11, reflecting a modified compulsory education law projected to reduce the number of dropouts by 20 percent in that year. The actual effect of this change will depend heavily on school district response to the law and enforcement activity at the state level.

Higher Education

Post-secondary education expenditures in the F.Y. 2000-2001 biennium are forecast to increase by \$25 million (1.1 percent) over F.Y. 1998-1999. Projected inflation costs of \$88 million are partially offset by a reduction of \$64 million in non-recurring appropriations to the University of Minnesota and MnSCU. Biennial appropriations before inflation decline by \$27 million (2.6 percent) for MnSCU and \$37 million (3.5 percent) for the University of Minnesota.

Property Tax Aids & Credits Projected to Increase Almost \$300 Million

Property Tax Aids and Credits expenditures for the 2000-01 biennium are expected to increase by \$300 million from 1998-99 biennial estimates. Of this increase, \$106 million is discretionary inflation. Due to a methodology change, this is the first forecast which adds discretionary inflation to this area of state spending.

The major contributor to the remaining \$194 million difference between the biennia is the Education Homestead Credit first enacted for F.Y. 1999. This credit will increase by \$181 million because it will be effective for two years of the biennium as compared to one year in the F.Y. 1998-99 biennium. Property Tax Refunds are expected to increase by \$52 million as a result of indexing of income categories and an upward trend in property rents and the market value of homes. Aid to Local Governments is

expected to increase by \$37 million due to indexing to a state and local government price deflator and lower than expected reductions to aid from net Tax Increment Financing penalties. The increases are offset by a \$93 million decline in Homestead and Agricultural Credit Aid resulting from continuing conversion of the school portion of this credit to special education aids. Various other changes account for the remaining net difference.

Health Care

Planning estimates for health care are forecast at \$3.972 billion, an increase of \$637 million (19.1 percent) over F.Y. 1998-99. Total spending in F.Y. 2000-01 includes \$146 million in discretionary inflation. This F.Y. 2000-01 spending level is \$292 million lower than anticipated at the end of the legislative session.

Health Care Expenditure Projections (\$ in millions)

	F.Y. 1998-99	F.Y. 2000-01	Difference
Medical Assistance:			
Long Term Care Facilities	\$1,145	\$1,211	\$65
Long Term Care Waivers	\$526	\$703	\$176
Aged & Disabled Basic Care	\$676	\$844	\$168
MFIP & Families Basic Care	\$622	\$695	\$73
General Assistance Medical Care	\$297	\$311	\$13
Chemical Dep. Treatment Fund	\$68	\$64	(\$4)
Discretionary Inflation		\$146	\$146
Total	\$3,335	\$3,972	\$637

The four segments of Medical Assistance (MA) are projected to increase by a total of \$482 million (16 percent) from F.Y. 1998-99 to F.Y. 2000-01. Spending increases are concentrated in the \$176 million change in MA Long Term Care (LTC) Waivers (home care and special services), and the \$168 million change in MA Aged & Disabled Basic Care. Caseload growth is a key factor for the expenditure increase in both programs. LTC Waivers are projected to add 8,400 enrollees, an increase of 31 percent. These people are also eligible for Basic Care benefits and account for a little over half of that program's 12.6 percent caseload growth. Projected increases in the average cost of health care also contribute to the forecast spending growth in the Basic Care program.

Biennial spending for MA Long Term Care Facilities costs is only expected to grow by \$65 million, or less than 1 percent. These costs have been relatively stable due to a moratorium on nursing home beds and changes in the nursing home industry. The growing number of elderly eligible for Medical Assistance are largely reflected in the growth of waived programs shown above.

The remaining program segments, MA MFIP and Families Basic Care, General Assistance Medical Care (GAMC), and Chemical Dependency entitlements are forecast to increase by \$82 million (8 percent) from the 1998-99 biennium. Most of the increase is due to higher average costs for care as per enrollee rates rise and program participants utilize more services.

Family Support Programs Expected to Decline Further

Planning estimates for family support programs are \$21 million higher than for F.Y. 1998-99. The total spending projection of \$573 million includes \$21 million for discretionary inflation. Changes to caseload projections cause most of the forecast spending growth, continuing the movement of expenditures from cash assistance programs to child care programs. Base spending for cash assistance programs decreases by \$79 million from F.Y. 1998-99 to F.Y. 2000-01, offset by an identical increase in child care spending. Child care expenditures are forecast to be great enough to ensure that Minnesota meets its TANF maintenance of effort requirement, and the general fund realizes the full forecast savings in the MFIP program. The relationship is discussed in greater detail within the Issue Highlight: Welfare Reform section.

Prison Costs Continue to Drive State Institution Spending

The planning estimate for the cost of operating state institutions (regional treatment centers, prisons, veteran's homes, Faribault Academies, and the Center for Arts Education) is projected to increase \$63 million in F.Y. 2000-01 over F.Y. 1998-99 levels. The cost of operating the state's growing prison system is a major contributor to those increases.

F.Y. 2000-01 planning estimates for correctional institutions show growth of \$47 million. Of this amount \$18 million represents the cost of additional prison bed needs projected during the 2000-01 biennium. This is down \$11 million from end-of-session estimates, which were based on prison population projections from December 1996 and adjusted for bed impacts projected for actions taken during the 1997 legislative session. The new November 1997 prison population projections show the average number of inmates down about 230 from previous estimates for the 2000-01 biennium. Changes in current inmate commitment levels, Minnesota Sentencing Guidelines, and projection methodologies contribute toward pushing previously projected increases out about two years. The remaining difference is due to growth and other changes between F.Y. 1998 and F.Y. 1999, annualization of program changes for juvenile institutions, and discretionary inflation.

For state institutions, the planning estimates include \$35 million in discretionary inflation.

All Other Spending

F.Y. 2000-2001 expenditure estimates for the continuation of all other government programs including constitutional offices, state agencies, and numerous grant-in-aid programs, are forecast to decrease by \$74 million from the current biennium after including discretionary inflation of \$77 million. Without the impact of discretionary inflation, total spending would decrease a total of \$151 million, from \$2.216 billion to \$2.065 billion. This decrease is in accordance with prior planning estimates, varying by only a net of \$3 million from the most recent estimate.

A number of factors contribute to this decline. One significant factor is the expenditure of approximately \$38 million in F.Y. 1998-99 that represents funds carried forward from the prior biennium. The largest factor is the inclusion of over \$125 million of "one time" appropriations in the enacted F.Y. 1998-1999 budget. These special expenditures are not repeated in the F.Y. 2000-2001 planning estimates. These appropriations cover the spectrum from small special project grants of a few thousand dollars to more significant appropriations for flood relief and special issues such as \$23 million for the conversion of state computer systems to correct the Year 2000 problem and \$18 million for Gulf War Veterans Bonus payments. The balance of the net decrease is composed of a variety of minor and technical factors.

ALTERNATIVE FORECAST COMPARISON

Real GDP (Annual Rates)

	<u>97II</u>	<u>97III</u>	<u>97IV</u>	<u>98I</u>	<u>98II</u>	<u>98III</u>	<u>96A</u>	<u>97A</u>	<u>98A</u>	<u>99A</u>
DRI Control (11-97)	3.3	3.5	2.7	1.9	1.8	1.3	2.8	3.8	2.3	2.0
Goldman-Sachs (10-97)	3.3	3.3	2.9	3.5	3.2	2.7	2.8	3.7	3.1	N.A
Blue Chip (11-97)	3.3	3.5	2.6	2.4	2.3	2.3	2.8	3.7	2.5	N.A
American Express (IDS) (11-97)	3.3	3.5	3.2	3.8	3.0	2.1	3.3*	3.7*	2.7*	N.A
Merrill-Lynch (11-97)	3.3	3.5	2.1	2.2	2.5	2.4	2.8	3.7	2.5	2.2
Georgia State (11-97)	3.3	3.5	2.4	2.6	2.4	3.1	1.6	3.7	2.7	2.4

*4Q/4Q

GDP Deflator (Chain-Weighted, Annual Rates)

	<u>97II</u>	<u>97III</u>	<u>97IV</u>	<u>98I</u>	<u>98II</u>	<u>98III</u>	<u>96A</u>	<u>97A</u>	<u>98A</u>	<u>99A</u>
DRI Control (11-97)	1.8	1.4	1.8	2.1	1.7	1.8	2.3	2.0	1.8	1.8
Goldman-Sachs (10-97)	2.2	1.9	1.9	1.7	1.9	2.1	2.3	2.0	2.0	N.A
Blue Chip (11-97)	1.8	1.4	2.0	2.3	2.3	2.3	2.3	2.0	2.2	N.A
American Express (IDS) (11-97)	1.8	1.4	1.9	2.6	2.7	2.8	2.3*	1.9*	2.7*	N.A
Merrill-Lynch (11-97)	1.8	1.4	1.4	1.4	2.1	1.8	2.3	2.0	1.7	1.7
Georgia State (11-97)	1.8	1.4	1.7	2.3	2.0	2.0	2.3	2.0	2.0	2.4

FORECAST COMPARISONS

Real Economic Growth (Annual Percent Change in Real GDP)

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Nov 93 DRI Control	2.1	3.1				
Feb 94 DRI Control	2.1	3.3				
Nov 94 DRI Control	2.1	3.0	1.8 ⁽¹⁾	1.8 ⁽¹⁾	1.8 ⁽¹⁾	1.8 ⁽¹⁾
Feb 95 DRI Control	1.7	3.0	1.7 ⁽¹⁾	1.7 ⁽¹⁾	1.7 ⁽¹⁾	1.7 ⁽¹⁾
Nov 95 DRI Control	2.1	2.8	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾
Feb 96 DRI Control	2.1	2.8	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾
Nov 96 DRI Control	2.4	2.4	2.4	2.0	1.6 ⁽³⁾	1.6 ⁽³⁾
Feb 97 DRI Control	2.5	2.9	2.1	2.1	1.6 ⁽³⁾	1.6 ⁽³⁾
Nov 97 DRI Control	2.8	3.8	2.3	2.0	2.5	1.7 ⁽⁴⁾

Inflation (Annual Percent Change in Implicit GDP Deflator - 1992=100)

Nov 93 DRI Control	2.7	2.4				
Feb 94 DRI Control	2.6	2.4				
Nov 94 DRI Control	2.7	2.8	3.7 ⁽³⁾	3.7 ⁽³⁾	3.7 ⁽³⁾	3.7 ⁽³⁾
Feb 95 DRI Control	2.4	2.3	3.2 ⁽³⁾	3.2 ⁽³⁾	3.2 ⁽³⁾	3.2 ⁽³⁾
Nov 95 DRI Control	2.0	1.9	2.1 ⁽⁴⁾	2.4 ⁽⁴⁾	2.1 ⁽⁴⁾	2.4 ⁽⁴⁾
Feb 96 DRI Control	1.9	1.7	2.1 ⁽⁵⁾	2.4 ⁽⁵⁾	2.1 ⁽⁵⁾	2.4 ⁽⁵⁾
Nov 96 DRI Control	2.1	2.4	2.3	2.4	2.6	2.8
Feb 97 DRI Control	2.0	1.9	2.3	2.5	2.7	2.9
Nov 97 DRI Control	2.3	2.1	2.0	2.1	2.3	2.3

(1) Long-term trend from DRI Cyclelong, Summer 1994 and Winter 1994/95.

(2) Long-term trend from DRI Cyclelong, Summer 1995.

(3) Long-term trend from DRI Cyclelong, Summer 1996.

(4) Long-term trend from DRI Cyclelong, Summer 1997.

(5) Summer 1994 Trendlong Forecast.

(6) November 1995 Trendlong.

MINNESOTA - U.S. COMPARISON REPORT

Annual Percent Changes

November 1997 Control

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Wage and Salary Income								
United States	5.6	3.5	4.9	5.8	5.9	6.5	5.2	4.3
Minnesota	7.8	4.0	5.8	6.4	7.8	5.5	5.2	4.6
Implied Annual Wage								
United States	5.3	1.5	1.8	3.1	3.8	4.2	3.2	2.9
Minnesota	5.4	1.3	2.7	3.4	5.5	3.2	3.3	3.2
Non-Farm Employment								
United States	0.3	1.9	3.1	2.7	2.0	2.2	1.9	1.4
Minnesota	2.3	2.7	3.0	2.9	2.2	2.2	1.8	1.4
Personal Income								
United States	5.9	4.6	4.9	6.2	5.6	5.4	4.7	4.0
Minnesota	7.6	3.2	7.2	5.9	7.7	5.1	4.7	4.0

Comparison of Actual and Estimated Non-Restricted Revenues

(\$ in thousands)

	1997 Fiscal Year			July - Oct. 1997		
	Forecast Revenues	Actual Revenues	Variance Act-Fcst	Forecast Revenues	Actual Revenues	Variance Act-Fcst
Four Major Revenues:						
Individual Income Tax						
Withholding	3,798,012	3,809,789	11,777	1,311,500	1,320,312	8,812
Declarations	878,096	888,288	10,192	186,900	188,662	1,762
Miscellaneous	417,592	615,894	198,302	44,400	56,958	12,558
Gross	5,093,700	5,313,970	220,270	1,542,800	1,565,931	23,131
Refunds	553,700	545,581	(8,119)	21,900	23,576	1,676
Net	4,540,000	4,768,389	228,389	1,520,900	1,542,355	21,455
Corporate & Bank Excise						
Declarations	675,463	678,654	3,191	189,700	212,334	22,634
Miscellaneous	91,137	98,014	6,877	36,000	27,201	(8,800)
Gross	766,600	776,668	10,068	225,700	239,534	13,834
Refunds	95,000	95,770	770	21,800	12,986	(8,814)
Net	671,600	680,898	9,298	203,900	226,549	22,648
Sales Tax						
Gross	3,159,128	3,139,399	(19,730)	1,039,170	1,043,281	4,111
Refunds	118,700	126,653	7,953	35,206	38,359	3,153
Net	3,040,428	3,012,746	(27,682)	1,003,964	1,004,922	958
Motor Vehicle Excise	377,500	401,751	24,251	125,400	156,167	30,767
Other Revenues :						
Inherit/Gift/Estate	40,000	49,882	9,882	16,808	12,964	(3,844)
Liquor/Wine/Beer	56,725	56,409	(316)	15,601	16,090	489
Cigarette & Tobacco	169,375	173,272	3,897	42,990	46,361	3,371
Deed and Mortgage	90,600	94,759	4,159	36,130	38,834	2,704
Insurance Gross Earnings	166,000	160,460	(5,540)	1,600	1,913	313
Lawful Gambling	66,587	63,295	(3,292)	17,718	17,241	(477)
Health Care Surcharge	128,060	125,995	(2,065)	36,254	38,150	1,896
Other Taxes	3,400	4,038	638	338	343	5
General Fund RTC Revenues	41,300	32,044	(9,256)	4,950	12,244	7,294
Income Tax Reciprocity	31,887	31,887	0	0	0	0
Investment Income	104,000	117,053	13,053	17,750	36,523	18,773
Other and Unallocated	64,000	85,985	21,985	23,896	27,018	3,122
Other Subtotal	961,934	995,079	33,145	214,035	247,681	33,646
Other Refunds	18,468	20,677	2,209	6,163	6,024	(140)
Other Net	943,466	974,401	30,935	207,872	241,657	33,786
Total Gross	10,358,862	10,626,867	268,005	3,147,105	3,252,595	105,490
Total Refunds	785,868	788,681	2,813	85,069	80,945	(4,125)
Total Net	9,572,994	9,838,186	265,192	3,062,036	3,171,650	109,614

FACTORS AFFECTING THE INDIVIDUAL INCOME TAX

(Dollars in Billions)

	Calendar Year					
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Minnesota Non-Farm Tax Base						
November 1993 Control	82.471	86.332				
February 1994 Control	83.460	87.098				
November 1994 Control	84.722	88.266	91.982	96.902		
February 1995 Control	84.733	88.744	91.190	96.611		
November 1995 Control	85.120	90.170	94.160	97.766		
February 1996 Control	85.120	90.490	94.170	97.880		
November 1996 Control	84.720	90.720	95.750	100.570	105.170	109.960
February 1997 Control	84.720	90.750	96.410	101.500	106.270	111.140
November 1997 Control	87.310	93.360	100.450	106.250	111.700	116.240
Minnesota Wage and Salary Income						
November 1993 Control	61.203	63.959				
February 1994 Control	61.883	64.403				
November 1994 Control	62.562	65.234	68.004	71.395		
February 1995 Control	62.649	65.641	68.310	71.447		
November 1995 Control	62.844	66.389	69.518	72.278		
February 1996 Control	62.844	66.739	69.754	72.680		
November 1996 Control	62.737	67.004	71.244	74.966	78.407	82.127
February 1997 Control	62.737	67.004	71.712	75.572	79.203	82.961
November 1997 Control	62.899	66.926	72.146	76.118	80.099	83.793
Minnesota Property Income						
November 1993 Control	14.919	15.720				
February 1994 Control	15.027	15.958				
November 1994 Control	15.442	16.219	16.961	18.013		
February 1995 Control	15.400	16.315	16.985	17.933		
November 1995 Control	15.428	16.679	17.408	17.994		
February 1996 Control	15.428	16.653	17.077	17.604		
November 1996 Control	15.245	16.678	17.084	17.987	18.925	19.740
February 1997 Control	15.245	16.678	17.212	18.133	19.011	19.782
November 1997 Control	17.948	19.547	21.053	20.300	23.196	23.623
Minnesota Proprietors' Income						
November 1993 Control	6.348	6.653				
February 1994 Control	6.550	6.737				
November 1994 Control	6.718	6.813	7.016	7.494		
February 1995 Control	6.831	6.787	6.895	7.232		
November 1995 Control	6.845	7.103	7.238	7.490		
February 1996 Control	6.845	7.098	7.337	7.597		
November 1996 Control	6.741	7.071	7.422	7.617	7.834	8.099
February 1997 Control	6.741	7.071	7.489	7.798	8.056	8.401
November 1997 Control	6.468	6.885	7.251	7.833	8.400	8.821

FACTORS AFFECTING SALES, CORPORATE INCOME AND MOTOR VEHICLE EXCISE TAXES

(Dollars in Billions)

	Fiscal Year					
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
SALES TAX						
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
November 1993 Control	6.533	6.666				
February 1994 Control	6.672	6.934				
November 1994 Control	6.677	7.192	7.236	7.577		
February 1995 Control	6.675	7.273	7.308	7.558		
November 1995 Control	6.673	7.378	7.764	8.031		
February 1996 Control	6.673	7.378	7.729	8.151		
November 1996 Control*	6.587	7.286	7.758	8.233	8.601	8.948
February 1997 Control	6.587	7.286	7.758	8.233	8.705	9.026
November 1997 Control	6.766	7.394	7.802	8.334	8.911	9.430
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
November 1993 Control	8.678	9.322				
February 1994 Control	9.265	9.794				
November 1994 Control	6.754	7.450	7.665	7.702		
February 1995 Control	6.755	7.683	8.029	7.935		
November 1995 Control	6.744	7.866	8.613	8.763		
February 1996 Control	6.744	7.857	8.679	8.971		
November 1996 Control	6.403	7.301	8.069	8.757	9.316	9.900
February 1997 Control	6.403	7.301	8.066	8.777	9.503	10.154
November 1997 Control	6.342	7.011	7.707	8.511	9.461	10.148
Minnesota's Proxy Share of U.S. Construction Spending						
November 1993 Control	9.412	9.809				
February 1994 Control	9.960	10.420				
November 1994 Control	4.680	4.770	4.813	4.973		
February 1995 Control	4.680	4.791	4.941	4.974		
November 1995 Control	4.511	4.641	4.830	5.024		
February 1996 Control	4.511	4.645	4.855	4.916		
November 1996 Control	4.525	4.759	4.966	5.105	5.243	5.356
February 1997 Control	4.525	4.759	4.966	5.170	5.290	5.344
November 1997 Control	4.501	4.735	5.015	5.436	5.752	6.018

*Reflects data revision.

FACTORS AFFECTING SALES, CORPORATE INCOME AND MOTOR VEHICLE EXCISE TAXES

(Dollars in Billions)

	Fiscal Year					
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
SALES TAX (Cont.)						
Minnesota Non-Farm Personal Income						
November 1993 Control	96.090	100.800				
February 1994 Control	96.070	102.000				
November 1994 Control	97.810	102.120	106.48	111.74		
February 1995 Control	97.680	102.430	106.84	111.63		
November 1995 Control	97.640	104.500	108.91	113.59		
February 1996 Control	97.640	104.340	109.15	113.74		
November 1996 Control	97.140	104.120	110.87	115.94	121.93	127.60
February 1997 Control	97.140	104.120	110.85	117.14	121.03	128.57
November 1997 Control	100.620	107.180	113.98	121.14	127.68	133.13

MOTOR VEHICLE EXCISE TAX

Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts Parts

November 1993 Control	4.944	5.356				
February 1994 Control	5.103	5.488				
November 1994 Control	4.929	5.320	5.322	5.491		
February 1995 Control	4.929	5.320	5.322	5.491		
November 1995 Control	4.948	5.264	5.479	5.560		
February 1996 Control	4.948	5.161	5.324	5.357		
November 1996 Control	4.948	5.149	5.310	5.381	5.582	5.806
February 1997 Control	4.948	5.149	5.310	5.290	5.404	5.625
November 1997 Control*	4.603	4.842	5.132	5.123	5.191	5.339

CORPORATE INCOME TAX (Calendar Year)

U.S. Corporation Profits

November 1993 Control	448.0	469.6				
February 1994 Control	439.9	471.1				
November 1994 Control	428.5	476.3	465.3	491.6		
February 1995 Control	425.6	480.2	460.8	467.7		
November 1995 Control	425.6	475.9	477.4	476.7		
February 1996 Control	432.0	476.2	472.5	476.6		
November 1996 Control*	491.0	576.8	624.6	618.2	642.6	671.4
February 1997 Control	491.0	576.8	624.6	645.3	659.6	677.8
November 1997 Control	535.1	622.6	676.6	723.9	737.4	762.6

*Change in definition

**F.Y. 1997 Actual vs End of Session
November 1997 Forecast**
(\$ in Thousands)

	8-97 Enacted F.Y. 1997	Closing F.Y. 1997	Difference
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,343,277	1,343,277	0
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	4,540,000	4,768,390	228,390
Sales Tax	3,040,428	3,012,746	(27,682)
Corporate Income Tax	671,600	680,898	9,298
Motor Vehicle Excise	377,500	401,751	24,251
Other Non-Dedicated Revenue	943,466	974,399	30,933
Subtotal Net Non-Ded. Rev.	9,572,994	9,838,184	265,190
Dedicated Revenue	130,255	139,517	9,262
Transfers In	206,736	215,149	8,413
Prior Year Adjustments	20,450	9,501	(10,949)
Subtotal-Current Resources	9,930,435	10,202,351	271,916
Total Resources Available	11,273,712	11,545,628	271,916
Actual & Estimated Spending by Function:			
Education /Children & Families	3,306,770	3,311,297	4,527
Property Tax Recognition	180,000	180,000	0
School Payment Change (90/10)	(156,421)	(156,423)	(2)
Post-Secondary Education	1,084,053	1,077,882	(6,171)
Property Tax Aids & Credits	1,212,944	1,208,115	(4,829)
Other Major Local Assistance	465,152	429,211	(35,941)
Health Care	1,496,332	1,462,253	(34,079)
Family Support	256,323	250,099	(6,224)
State Operated Institutions	429,037	429,373	336
Legisl., Judicial, Const. Officers	251,910	242,281	(9,629)
State Agencies' Operations & Grants	766,644	756,402	(10,242)
Debt Service	241,345	241,826	481
Estimated Cancellations	(21,000)	0	21,000
Subtotal-Major Spending Categories	9,513,089	9,432,316	(80,773)
Dedicated Expenditures	130,255	118,592	(11,663)
Total Expenditures & Transfers	9,643,344	9,550,908	(92,436)
Balance Before Reserves	1,630,368	1,994,720	364,352
Cash Flow Account	350,000	350,000	0
Budget Reserve	233,500	233,500	0
School Aid Reserve	113,800	113,800	0
Dedicated Reserves	72,000	92,695	20,695
Appropriations Carried Forward	NA	37,669	37,669
Budgetary Balance	861,068	1,167,056	305,988

F.Y. 1998-99 Forecast Change (Before Statutory Allocations)
November 1997 Forecast
(\$ in Thousands)

	End of Session F.Y. 1998-99	11-97 Fcst F.Y. 1998-99	Difference
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,630,368	1,994,720	364,352
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	9,023,439	9,479,300	455,861
Sales Tax	6,548,900	6,546,700	(2,200)
Corporate Income Tax	1,408,600	1,508,600	100,000
Motor Vehicle Excise	734,700	797,400	62,700
Other Non-Dedicated Revenue	1,825,278	1,892,699	67,421
Subtotal Net Non-Ded. Rev.	19,450,917	20,224,699	683,782
Dedicated Revenue	241,557	294,078	52,521
Transfers In	492,732	505,848	13,116
Prior Year Adjustments	40,900	20,200	(20,700)
Subtotal-Current Resources	20,316,106	21,044,825	728,719
Total Resources Available	21,946,474	23,039,545	1,093,071
Actual & Estimated Spending by Function:			
Education /Children & Families	6,885,486	6,852,516	(32,970)
Property Tax Recognition	18,700	18,700	0
Post-Secondary Education	2,370,068	2,377,227	7,159
Property Tax Aids & Credits	2,611,075	2,590,140	(20,935)
Other Major Local Assistance	1,000,831	980,282	(20,549)
Health Care	3,571,576	3,334,774	(236,802)
Family Support	584,721	552,552	(32,169)
State Operated Institutions	893,333	891,669	(1,664)
Legisl., Judicial, Const. Officers	478,056	484,675	6,619
State Agencies' Operations & Grants	1,706,799	1,731,484	24,685
Debt Service	582,359	580,977	(1,382)
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal-Major Spending Categories	20,683,004	20,374,996	(308,008)
Dedicated Expenditures	241,577	294,078	52,521
Total Expenditures & Transfers	20,924,561	20,669,074	(255,487)
Balance Before Reserves	1,021,913	2,370,471	1,348,558
Cash Flow Account	350,000	350,000	0
Budget Reserve	522,000	522,000	0
Property Tax Account	46,000	46,000	0
Dedicated Reserves	72,000	92,695	20,695
Budgetary Balance	31,913	1,359,776	1,327,863

F.Y. 1998-99 General Fund Budget
November, 1997 Forecast
(\$ in Thousands)

	F.Y. 1998	F.Y. 1999	Biennial Total
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,994,720	1,955,102	1,994,720
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	4,360,800	5,037,300 ⁽¹⁾	9,398,100 ⁽¹⁾
Sales Tax	3,194,100	3,352,600	6,546,700
Corporate Income Tax	758,200	750,400	1,508,600
Motor Vehicle Excise	403,400	394,000	797,400
Other Non-Dedicated Revenue	953,133	939,566	1,892,699
Subtotal Net Non-Ded. Rev.	9,669,633	10,473,866	20,143,499
Dedicated Revenue	154,823	139,255	294,078
Transfers In	265,055	240,793	505,848
Prior Year Adjustments	10,100	10,100	20,200
Subtotal-Current Resources	10,099,611	10,864,014	20,963,625
Total Resources Available	12,094,331	12,819,116	22,958,345
Actual & Estimated Spending by Function:			
Education /Children & Families	3,354,724	3,497,792	6,852,516
Property Tax Recognition	18,700	0	18,700
Post-Secondary Education	1,185,247	1,191,980	2,377,227
Property Tax Aids & Credits	1,211,662	1,378,478	2,590,140
Other Major Local Assistance	493,635	486,647	980,282
Health Care	1,586,334	1,748,440	3,334,774
Family Support	258,596	293,956	552,552
State Operated Institutions	442,611	449,058	891,669
Legisl., Judicial, Const. Officers	257,113	227,562	484,675
State Agencies' Operations & Grants	925,707	805,777	1,731,484
Debt Service	255,077	325,900	580,977
Estimated Cancellations	(5,000)	(15,000)	(20,000)
Subtotal-Major Spending Categories	9,984,406	10,390,590	20,374,996
Dedicated Expenditures	154,823	139,255	294,078
Total Expenditures & Transfers	10,139,229	10,529,845	20,669,074
Balance Before Reserves	1,955,102	2,289,271	2,289,271
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	522,000	522,000	522,000
Property Tax Account	830,000	872,000 ⁽²⁾	872,000 ⁽²⁾
Dedicated Reserves	92,695	92,695	92,695
Budgetary Balance	160,407	452,576	452,576

(1) Includes education tax credits and deductions effective tax year 1998. F.Y. 1999 income tax revenues have been reduced \$81 million.

(2) Includes statutory allocations of \$767 million and dedicated interest of \$59 million added to beginning balance of \$46 million.

Comparison: Planning Estimates vs Forecast**November, 1997 Forecast**

(\$ in Thousands)

	11-97 Fcst F.Y.1998-99	11-97 Plng Est F.Y. 2000-01	\$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,994,720	2,289,271	294,551	14.8%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	9,398,100 ⁽¹⁾	10,855,000 ⁽¹⁾	1,456,900	15.5%
Sales Tax	6,546,700	7,163,300	616,600	9.4%
Corporate Income Tax	1,508,600	1,602,500	93,900	6.2%
Motor Vehicle Excise	797,400	817,700	20,300	2.5%
Other Non-Dedicated Revenue	1,892,699	1,809,052	(83,647)	-4.4%
Subtotal Net Non-Dedic Revenue	20,143,499	22,247,552	2,104,053	10.4%
Dedicated Revenue	294,078	278,510	(15,568)	-5.3%
Transfers In	505,848	473,617	(32,231)	-6.4%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	20,963,625	23,019,879	2,056,254	9.8%
Total Resources Available	22,958,345	25,309,150	2,350,805	10.2%
Actual & Estimated Spending by Function				
Education / Children & Families	6,852,516	7,375,534	523,018	7.6%
Property Tax Recognition	18,700	0	(18,700)	-100.0%
Post-Secondary Education	2,377,227	2,402,235	25,008	1.1%
Property Tax Aids & Credits	2,590,140	2,890,087	299,947	11.6%
Other Major Local Assistance	980,282	1,044,317	64,035	6.5%
Health Care	3,334,774	3,972,131	637,357	19.1%
Family Support	552,552	573,398	20,846	3.8%
State Operated Institutions	891,669	954,536	62,867	7.1%
Legisl., Judicial, Const. Officers	484,675	522,843	38,168	7.9%
State Agencies' Operations & Grants	1,731,484	1,618,593	(112,891)	-6.5%
Debt Service	580,977	607,618	26,641	4.6%
Estimated Cancellations	(20,000)	(20,000)	0	0.0%
Subtotal-Major Spending Categories	20,374,996	21,941,291	1,566,295	7.7%
Dedicated Expenditures	294,078	278,510	(15,568)	-5.3%
Total Expenditures & Transfers	20,669,074	22,219,801	1,550,727	7.5%
Balance Before Reserves	2,289,271	3,089,349	800,078	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	522,000	522,000	0	
Property Tax Account	872,000	872,000	0	
Dedicated Reserves	92,695	61,355	(31,340)	
Budgetary Balance	452,576	1,283,994	831,418	

(1) Includes education tax credits and deductions effective tax year 1998. F.Y. 1998-99 income tax revenues have been reduced \$81 million and F.Y. 2000-01 revenues have been reduced \$171.5 million.

F.Y. 2000-01 Planning Estimates
November 1997 Forecast
(\$ in Thousands)

	Closing F.Y. 1996-97	11-97 Fcst F.Y. 1998-99	11-97 Plng Est F.Y. 2000-01
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,020,499	1,994,720	2,289,271
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	8,903,722	9,398,100	10,855,000
Sales Tax	5,914,014	6,546,700	7,163,300
Corporate Income Tax	1,382,633	1,508,600	1,602,500
Motor Vehicle Excise	782,970	797,400	817,700
Other Non-Dedicated Revenue	1,842,349	1,892,699	1,809,052
Subtotal Net Non-Ded. Rev.	18,825,688	20,143,499	22,247,552
Dedicated Revenue	276,505	294,078	278,510
Transfers In	483,104	505,848	473,617
Prior Year Adjustments	18,022	20,200	20,200
Subtotal-Current Resources	19,603,319	20,963,625	23,019,879
Total Resources Available	20,623,818	22,958,345	25,309,150
Actual & Estimated Spending by Function:			
Education /Children & Families	6,200,408	6,852,516	7,375,534
Property Tax Recognition	494,832	18,700	0
School Payment Change (90/10)	(156,423)	0	0
Post-Secondary Education	2,140,028	2,377,227	2,402,235
Property Tax Aids & Credits	2,420,701	2,590,140	2,890,087
Other Major Local Assistance	817,190	980,282	1,044,317
Health Care	2,845,533	3,334,774	3,972,131
Family Support	499,522	552,552	573,398
State Operated Institutions	826,983	891,669	954,536
Legisl., Judicial, Const. Officers	468,567	484,675	522,843
State Agencies' Operations & Grants	1,422,406	1,731,484	1,618,593
Debt Service	439,415	580,977	607,618
Estimated Cancellations	0	(20,000)	(20,000)
Subtotal-Major Spending Categories	18,419,162	20,374,996	21,941,291
Dedicated Expenditures	209,936	294,078	278,510
Total Expenditures & Transfers	18,629,098	20,669,074	22,219,801
Balance Before Reserves	1,994,720	2,289,271	3,089,349
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	233,500	522,000	522,000
Property Tax Account	0	872,000	872,000
School Aid Reserve	113,800	0	0
Dedicated Reserves	92,695	92,695	61,355
Appropriations Carried Forward	37,669	0	0
Budgetary Balance	1,167,056	452,576	1,283,994

F.Y. 2000-01 Base, Inflation, Planning Estimates
November 1997 Forecast
(\$ in Thousands)

	Base F.Y. 2000-01	Inflation F.Y. 2000-01	Total Planning Est
Actual & Estimated Resources:			
Balance Forward From Prior Year	2,289,271	0	2,289,271
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	10,855,000	0	10,855,000
Sales Tax	7,163,300	0	7,163,300
Corporate Income Tax	1,602,500	0	1,602,500
Motor Vehicle Excise	817,700	0	817,700
Other Non-Dedicated Revenue	1,809,052	0	1,809,052
Subtotal Net Non-Ded. Rev.	22,247,552	0	22,247,552
Dedicated Revenue	278,510	0	278,510
Transfers In	473,617	0	473,617
Prior Year Adjustments	20,200	0	20,200
Subtotal-Current Resources	23,019,879	0	23,019,879
Total Resources Available	25,309,150	0	25,309,150
Actual & Estimated Spending by Function:			
Education /Children & Families	7,106,858	268,676	7,375,534
Post-Secondary Education	2,314,711	87,524	2,402,235
Property Tax Aids & Credits	2,783,700	106,387	2,890,087
Other Major Local Assistance	1,006,218	38,099	1,044,317
Health Care	3,826,550	145,581	3,972,131
Family Support	552,449	20,949	573,398
State Operated Institutions	919,680	34,856	954,536
Legisl., Judicial, Const. Officers	503,793	19,050	522,843
State Agencies' Operations & Grants	1,560,842	57,751	1,618,593
Debt Service	607,618	0	607,618
Estimated Cancellations	(20,000)	0	(20,000)
Subtotal-Major Spending Categories	21,162,419	778,872	21,941,291
Dedicated Expenditures	278,510	0	278,510
Total Expenditures & Transfers	21,440,929	778,872	22,219,801
Balance Before Reserves	3,868,221	(778,872)	3,089,349
Cash Flow Account	350,000	0	350,000
Budget Reserve	522,000	0	522,000
Property Tax Account	872,000	0	872,000
Dedicated Reserves	61,355	0	61,355
Budgetary Balance	2,062,866	(778,872)	1,283,994